

Joint Legislative Study Committee on Uniform Transaction Privilege Tax

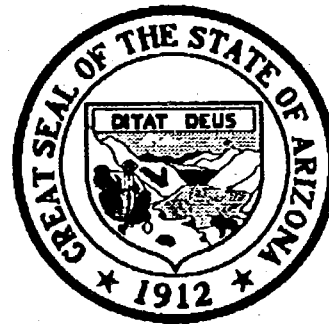
Final Report

December 31, 1999

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Arizona Legislature
Joint Legislative Study Committee
on Uniform Transaction Privilege Tax



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Final Report

**Submitted to the Governor, President of the Senate, Speaker of the House
And Chairmen of the Senate Finance and House Ways and Means Committees
December 31, 1999**

Committee Members:

Representative Daniels (chair)
Representative McGibbon
Representative Valadez

Mayor Scruggs
Tami Ryall

Senator Bundgaard (co-chair)
Senator Bennett
Senator Cunningham

Kevin McCarthy
Kathy Turken

Joint Legislative Study Committee Uniform Transaction Privilege Tax Study Committee— Final Report

Enabling Legislation: Laws 1999, Chapter 225, (HB 2193) established the Joint Legislative Study Committee on Uniform Transaction Privilege Tax. This legislation sunset the Municipal Tax Code Commission on July 1, 2000 and appointed the study committee to study the elimination of the Model City Tax Code and its replacement with a uniform state and local transaction privilege tax. The Committee was required to submit their findings to the Governor, the President of the Senate, the Speaker of the House, and the chairmen of the Senate Finance and House Ways and Means Committees. The Committee was repealed after December 31, 1999. A copy of the enabling legislation can be found in Appendix A of this report.

Committee Membership The Committee's membership included both Legislators and appointed public and private sector members representing a diverse range of interests. The membership of the Committee was as follows:

Committee Members

Representative Daniels (chair)
Representative McGibbon
Representative Valadez

Senator Bundgaard (co-chair)
Senator Bennett
Senator Cunningham

Mayor Scruggs
Kevin McCarthy
Tami Ryall
Kathy Turken

Committee's Report: The Committee conducted three public hearings to gather testimony regarding the elimination of the Model City Tax Code. The first meeting included presentations by legislative staff on the background of the Model City Tax Code and national sales tax uniformity issues. The Arizona League of City and Towns also provided testimony comparing the State and Model City Tax Codes. In addition, the business community provided testimony on the complexity of the current system.

The second hearing provided an opportunity for additional public input on the Model City Tax Code and testimony from the Department of Revenue on the Joint Audit Program. At the third hearing, Mayor Scruggs submitted a list of recommendations for the Committee to consider adopting.

While the Committee discussed recommendations submitted by Mayor Scruggs, no recommendations were voted on or adopted by the Committee. The agendas, minutes and submitted materials are included as appendixes to this report for information purposes. *However, it is important to emphasize that the Committee did not adopt any recommendations but only discussed the recommendations contained in the appendixes.*

List of Appendixes

Appendix A: Laws 1999, Chapter 225 (HB 2193)

Appendix B: Committee Agendas and Meeting Minutes

Appendix C: Recommendations submitted by Mayor Scruggs on behalf of the Cities and Towns for changes to the local sales tax system.

Appendix D: Testimony and Recommendations submitted by Ann Dumenil, Attorney at Law.

Appendix E: League of Arizona Cities & Towns Comparison of the State and Model City Tax Codes.

Appendix F: Letter from the Department of Revenue on the Uniform Audit Committee.

Appendix G: Responses from cities not in the state collection system on TPT administration and Audit and Major State Revenues Shared with Cities & Towns.

Appendix A:
Laws 1999, Chapter 225 (HB 2193)

Conference Engrossed
State of Arizona House of Representatives Forty-fourth Legislature First Regular Session 1999
CHAPTER 225
HOUSE BILL 2193

AN ACT

REPEALING SECTION 41-2999.09, ARIZONA REVISED STATUTES; AMENDING TITLE 41, CHAPTER 27, ARTICLE 2, ARIZONA REVISED STATUTES, BY ADDING SECTION 41-3000.35; AMENDING SECTIONS 42-6052 AND 42-6053, ARIZONA REVISED STATUTES; RELATING TO THE MUNICIPAL TAX CODE COMMISSION.

Be it enacted by the Legislature of the State of Arizona:

Section 1. Repeal

Section 41-2999.09, Arizona Revised Statutes, is repealed.

Sec. 2. Title 41, chapter 27, article 2, Arizona Revised Statutes, is amended by adding section 41-3000.35, to read:

41-3000.35. Municipal tax code commission; termination July 1, 2000

A. THE MUNICIPAL TAX CODE COMMISSION TERMINATES ON JULY 1, 2000.

B. SECTION 42-6052 IS REPEALED ON JANUARY 1, 2001.

Sec. 3. Section 42-6052, Arizona Revised Statutes, is amended to read:

42-6052. Municipal tax code commission

A. The municipal tax code commission is established consisting of the director of the department of revenue, or the director's representative, as an ex officio member without the power to vote and seven members who are mayors or members of the governing bodies of cities or towns that have adopted the model city tax code and who are appointed by the governor pursuant to section 38-211, at least one of whom shall be from a city or town having a population of less than twenty-five thousand persons according to the most recent United States decennial or special census. No more than three members of the commission may be from any one city or town. The commission shall annually elect a chairman from among its members.

B. Appointive members shall serve terms of three FOUR years. Members of the commission are not eligible for compensation for their services.

C. The commission shall meet at least twice each year and hold additional meetings on the call of the chairman or at the request of three or more of its members. The department of revenue shall provide staff support and meeting accommodations for the commission.

D. The commission shall prepare an annual report and deliver the report to the governor, the president of the senate and the speaker of the house of representatives before January 1 in each year.

Sec. 4. Section 42-6053, Arizona Revised Statutes, is amended to read:

42-6053. Review and comment on proposed changes to model city tax code

A. At least sixty days before adopting any modification or amendment of the model city tax code a city or town shall submit the proposed modification or amendment to the municipal tax code commission for review and recommendation.

B. The commission shall review and comment on language submitted by any city, town or taxpayer for the purpose of describing, defining, deleting, adding or otherwise modifying taxable activities, exemptions, administrative procedures or regulations relating to the model city tax code. The commission may hold public hearings within thirty days after receiving a proposed amendment or modification for the purpose of reviewing and receiving comments on the proposed changes, shall consider any information and testimony presented at the hearing, may recommend REQUIRE changes to the language presented at the hearing and may recommend REQUIRE changes to the language presented by the city or town or taxpayer. THE CITY OR TOWN SHALL NOT ADOPT A MODIFICATION OR AMENDMENT OF ANY PROVISION OF THE MODEL CITY TAX CODE UNLESS IT HAS BEEN APPROVED BY THE COMMISSION. Changes in rates of tax are not subject to review, but a city

or town imposing a new or different tax rate shall notify the commission within ten days after passage of the ordinance imposing the rate change.

C. The commission shall notify all cities and towns in writing of any change to the model city tax code adopted by any city or town and may recommend REQUIRE that the change be adopted by all cities and towns. The commission shall maintain a master list of all amendments to the model city tax code adopted by each city and town and shall make copies of the list available to the public on request.

~~D. The failure of the commission to approve an amendment or modification of the model city tax code does not prohibit taxation or exemption of a category, item or activity or changes in administrative procedures or regulations by a city or town, but the city or town shall transmit a copy of all final actions by a city or town to change the code, procedures or regulations to the commission.~~

Sec. 5. Uniform transaction privilege tax study committee

A. The uniform transaction privilege tax study committee is established consisting of:

1. Three senators appointed by the president of the senate, no more than two of whom may be from the same political party.

2. Three members of the house of representatives appointed by the speaker of the house of representatives, no more than two of whom may be from the same political party.

3. Two members, one each appointed by the president of the senate and the speaker of the house of representatives, who represent businesses that pay transaction privilege taxes.

4. Two members, one each appointed by the president of the senate and the speaker of the house of representatives, who are knowledgeable in the levy and collection of transaction privilege taxes and who represent municipalities that levy transaction privilege taxes.

B. Members shall serve without compensation or reimbursement of expenses.

C. The committee shall:

1. Study the elimination of the model city tax code and its replacement by a uniform state and local transaction privilege tax base.

2. Identify classes of businesses that are appropriate as local option tax classifications for taxation by municipalities.

3. Determine the financial impact to the state and municipalities of a uniform transaction privilege tax base.

4. Examine the impact to taxpayers from unifying the state and local transaction privilege tax base.

5. On or before December 15, 1999, report its findings and recommendations to the president of the senate, the speaker of the house of representatives, the chairmen of the senate finance committee and the house of representatives ways and means committee and the governor.

Sec. 6. Intent

Pursuant to section 41-2955, subsection B, Arizona Revised Statutes, the legislature intends to continue the municipal tax code commission for one year to promote uniformity and consistency among the excise tax bases of the municipalities and this state.

Sec. 7. Delayed repeal

Section 5 of this act, relating to the uniform transaction privilege tax study committee, is repealed from and after December 31, 1999.

Sec. 8. Retroactivity

A. Sections 1, 2 and 4 of this act are effective retroactively to July 1, 1999.

B. Section 42-6052, Arizona Revised Statutes, as amended by this act, applies retroactively to from and after January 18, 1996.

APPROVED BY THE GOVERNOR MAY 13, 1999.

FILED IN THE OFFICE OF THE SECRETARY OF STATE MAY 13, 1999.

Appendix B:
Committee Agendas & Minutes

ARIZONA STATE LEGISLATURE

Interim Meeting Notice

Open to the Public

Uniform Transaction Privilege Tax Study Committee

DATE: Tuesday, October 26, 1999

TIME: 10:00 a.m.

PLACE: Senate Hearing Room 3

AGENDA

- I Opening Remarks
- II Presentations:
 - (a) Staff Presentation – Background Information
 - (b) State & Model City Tax Code Comparison – Arizona League of Cities and Towns
 - (c) Taxpayer Perspectives
 - (d) Joint Audit Program – Department of Revenue
- III Public Comment
- IV Committee Business
- V Adjournment

MEMBERS: (See Attached)

MEMBERS:

Senator Scott Bundgaard, Co-Chair
Senator Ken Bennett
Senator George Cunningham

Representative Lori Daniels, Co-Chair
Representative Bill McGibbon
Representative Ramon Valadez

Mr. Kevin McCarthy, Arizona Tax Research Association
Ms. Tami Ryall, Town of Gilbert
Mayor Elaine Scruggs, City of Glendale
Ms. Kathy Turken, Turken Industrial Properties

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10/8/1999

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ARIZONA STATE LEGISLATURE

Interim Meeting Notice

Open to the Public

Uniform Transaction Privilege Tax Study Committee

DATE: Monday, November 8, 1999
TIME: 10:00 a.m.
PLACE: Senate Appropriations Room 109

AGENDA

- I Presentation
Joint Audit Program – Department of Revenue
- II Staff Update
- III Public Comment
- IV Committee Business
- V Adjournment

MEMBERS:

Senator Scott Bundgaard, Co-Chair	Representative Lori Daniels, Co-Chair
Senator Ken Bennett	Representative Bill McGibbon
Senator George Cunningham	Representative Ramon Valadez
Mr. Kevin McCarthy, Arizona Tax Research Association	
Ms. Tami Ryall, Town of Gilbert	
Mayor Elaine Scruggs, City of Glendale	
Ms. Kathy Turken, Turken Industrial Properties	

ARIZONA STATE LEGISLATURE

Interim Meeting Notice

Open to the Public

Uniform Transaction Privilege Tax Study Committee

DATE: Monday, December 6, 1999

TIME: 10:00 a.m.

PLACE: Senate Hearing Room 3

AGENDA

- I Call to Order
- II Public Testimony
- III Public Comment
- IV Discussion of Recommendations

MEMBERS:

Senator Scott Bundgaard, Co-Chair

Senator Ken Bennett

Senator George Cunningham

Mr. Kevin McCarthy, Arizona Tax Research Association

Ms. Tami Ryall, Town of Gilbert

Mayor Elaine Scruggs, City of Glendale

Ms. Kathy Turken, Turken Industrial Properties

Representative Lori Daniels, Co-Chair

Representative Bill McGibbon

Representative Ramon Valadez

ARIZONA STATE LEGISLATURE

UNIFORM TRANSACTION PRIVILEGE TAX STUDY COMMITTEE

**Minutes of the Meeting
Tuesday, October 26, 1999
Senate Hearing Room 3 10:00 a.m.**

Members Present:

Senator Scott Bundgaard, Cochair
Senator George Cunningham
Kevin McCarthy
Tami Ryall

Representative Lori Daniels, Cochair
Representative Bill McGibbon
Representative Ramon Valadez
Mayor Elaine Scruggs

Members Absent:

Senator Ken Bennett
Kathy Turken

Staff:

Jeff Kros, Senate Finance Analyst
Melodie Jones, House Ways and Means Analyst

Representative Daniels called the meeting to order at 10:08 a.m. and attendance was noted. She read the purpose of the Committee, which is "to study the elimination of the Model City Tax Code and its replacement by the uniform state transaction privilege tax (TPT); identify classes of business that are appropriate as local tax options for taxation by municipalities; determine the financial impact to the state and municipalities of a uniform TPT base; examine the impact to taxpayers from unifying the state and local TPT base. Ms. Daniels stated she has proposed similar bills in the past because she believes it will be more fair to the business community. She said she plans for this to be revenue neutral and that it will not impact the cities and towns in anyway.

STAFF PRESENTATION

Melodie Jones, House Ways and Means Analyst, gave the background on the Municipal Tax Code Commission, which was established by Laws 1988, Chapter 107, and was extended by Laws 1991, Chapter 106. She stated all cities and towns that impose a TPT adopted the Model City Tax Code. Ms. Jones noted it was again extended in 1994 under a sunset review. In 1998, the Commission again was under sunset review and was extended to January 1, 2000. She stated H.B. 2193 (Laws 1999, Chapter 225) extended the Commission to July 1, 2000. The Commission was to meet at least twice a year and comment on any changes to city ordinances submitted by cities, town or taxpayer that modified the tax code. She noted that H.B. 2193 requires the Commission to approve the changes. She distributed a packet which presents some of the national information for comparison (Attachment A).

Ms. Jones said that page 4 of the packet notes that 16 states do not have local sales or use taxes for cities and counties. She said New Hampshire, Oregon, Alaska, Montana and Delaware have no state sales tax and no local sales tax. Alaska does allow for cities to have local sales tax. Of the states that do have local sales tax, there is a division among those that have the jurisdictions administer the tax and those that have the state administer the tax. Ms. Jones said there are just a few which allow municipalities to administer the sales tax, including Colorado, South Dakota, Louisiana, Idaho, Minnesota, Arizona and Alabama. According to the study by the Urban Institute, conformity is a difficult issue to track and to keep up with the statutes. For the most part, the state that has locally administered taxes does not restrict that municipality to a tax base. The taxes emerge from home rule or licensing practices. Ms. Jones noted that in states with dual systems, the same differences which occur in local taxes also occur in the state taxes.

With regard to conformity, Ms. Jones said when the state administers the sales tax, there are still many differences between the cities and the state bases. She noted in Arizona, the State does not tax food, while some municipalities do. She pointed out a list of the differences exists in the packet. Ms. Jones referred to page 11 and discussed the information thereon. She noted cities have a wide variation of taxes they charge. The next page points out the limits or statutory revisions on tax rates. She said some states have maximum rates they can charge.

Ms. Jones attested for Arizona cities, the tax rate ranges from 1% to greater than 3%. There are 10 cities with a 1% tax on general retail; the majority are between 1.5% and 2%. She called attention to the table displaying the current tax rates by the cities, and stated that the highest tax is the City of Phoenix on telecommunications. Ms. Jones pointed out there are areas in State statutes where the cities have been pre-empted, and they cannot include certain items in their tax bases, i.e., those under Title 42, Chapter 6, including gross proceeds for exhibitions sponsored by non-profit organizations. She listed several of the exempt items.

Ms. Jones stated that Arizona is one of the few with a dual system of administration; some cities collect their own taxes, while others contract with the Department of Revenue (DOR) to administer their taxes. She called attention to the list of non-client cities. Ms. Jones said that a survey had been mailed to the non-client cities, the results of which are included in the packet. Of specific interest, she said the audit budget for different municipalities can range from \$100,000 to \$2.1 million. The money collected from sales tax audits range from \$100,000 to \$3.4 million.

Representative Daniels clarified that Prescott spends \$100,000 on sales tax audits, but only raises \$98,500. Ms. Jones responded that is the data Prescott gave. She said she believes there is greater compliance elsewhere, and that this only indicates the persons who were audited. She indicated the chart only shows what was received in assessments, and not the net.

Ms. Jones stated the survey also asked about e-commerce policies enacted by the cities. She noted e-commerce is a great concern, statewide and nationally. Chandler is applying internet access charges, while most cities are following the State lead, and the State is not currently charging on internet access.

Representative McGibbon asked if DOR conducts the audits for client cities on their own or if the client cities request the audits. Ms. Jones responded DOR will be giving a presentation for the audit procedure, but DOR conducts the cities audits at the same time it conducts its own audit of that city.

Representative McGibbon questioned Chandler's taxation of internet access but not internet sales transactions. Ms. Jones said Chandler is using the same policy as for its TPT and if the city feels it has nexus it is charging TPT on that item.

Kevin McCarthy, Arizona Tax Research Association (ATRA), stated he believes Chandler does differ in that it is taxing the internet access charges, which has nothing to do with nexus. Ms. Jones said that is correct, and she brought it out because Chandler answered that on the survey, and she does not know if any other cities are doing this. Mr. McCarthy asked what part of the Model City Tax Code they are using to tax internet access. Ms. Jones replied she did not follow up on that.

Mr. McCarthy asked Ms. Jones to review chart 5 - States with Locally Administered Sales Tax, and asked for a definition of locally administered sales tax. Ms. Jones responded this chart shows which cities actually administer the sales tax in which businesses must submit to the municipalities. The states not listed on this chart are those which have contracted with their departments of revenue to collect.

Mr. McCarthy asked if each of the cities listed has its own audit function separate from the state. Ms. Jones responded she would have to go back and see how many have separate audits. She said she believes they are being audited when the state does the audit.

Mr. McCarthy said that suggests they have a uniform tax system and the taxpayers simply cut separate checks to the city and state. He said that is markedly different than what is being discussed in Arizona, and asked if that is correct. Ms. Jones said she would find out.

STATE & MODEL CITY TAX CODE COMPARISON

Catherine Connolly, Executive Director, Arizona League of Cities and Towns, said her handout "Difference Between the Model City Tax Code and the State Tax Code" (Attachment B), provides some history and a comparison of the Model City Tax Code. She noted in January, 1984, the business community, led by the State and Phoenix Chambers of Commerce, attempted to pre-empt local sales tax authority at the Legislature. The Legislature set up the municipal sales tax study commission, which deliberated for a year and came up with recommendations that the cities be charged

with the responsibility of developing a Model City Tax Code. They were trying to strike a balance between the interests of the business community and the interest of the cities while maintaining local control over the local revenue. The cities worked on a draft for some time because it meant dealing with individual ordinances from every city in the State. The cities agreed to give up their individualism and work within the context of the Model City Tax Code which maintained local control and recognized the problems each had under the tax system. By the spring of 1987, all of the major cities and towns had adopted the Model City Tax Code, and everyone else followed within the next six months.

Ms. Connolly stated the first Commission, created in 1988, consisted of two city representatives, two business representatives and the director of DOR. That Commission was renewed in 1991, but in 1994 the business community decided they would like more local policy makers, and the Commission was changed to a seven member body of elected officials. That Commission is in effect today. As part of the last series of discussions on the Model City Tax Code, there was an attempt to pre-empt the cities. The problems were found to be within the taxation of manufacturing. A set of amendments was developed dealing with manufacturers, and the business community agreed not to pre-empt the cities for five years. That agreement expired in May, 1999.

Ms. Connolly stated the 1999 amendments to the Model City Tax Code are currently being reviewed by the cities, and hopefully, will go into effect in January, 2000.

Ms. Connolly noted the League of Cities and Towns developed the book in which the multi-jurisdictional taxpayer can find out what he is going to pay in each community, they will know the tax code and what the options are. The book also provides a contact phone number.

Ms. Connolly stated Representative Daniels had asked the League to prepare a comprehensive comparison of the city tax codes to the State tax code., and the League has attempted to do so. She noted that when the Model City Tax Code was developed the State tax code was not used as a basis. There is a recognition that the city tax base is broader than the State tax base, and the State has more exemptions. One of the main differences is nexus, or how it is decided who gets the money from a sale. She said doing the comparison Representative Daniels requested, was an interesting process. She reviewed each item, saying that Administration of taxes was very similar in the State and cities. Definitions in the Model City Tax Code are placed in the same section, while the State Code put them throughout the code within each classification. The State does not have an advertising tax. Under amusements, she noted the differences are so minute they are not worth discussing.

Ms. Connolly said that contracting is one of the biggest differences between the tax codes. The cities tax a broader base on contracting, and attempt to capture all points in that base because of the impact of building on those jurisdictions. The State allows a deduction for land, while the cities do not. Speculative builders are taxed by the cities

and not by the State. Hotel and transient occupancy are one large category in the state code, but the cities have divided it up because some cities do not have a bed (transient) tax. Ms. Connolly noted the cities and towns do not have jet fuel sales, so it is a local option, and those where it takes place codes are in conformance with the State code.

Ms. Connolly said the manufactured housing industry had approached the League with language they would like to have in the Code rather than the way the cities or the State were taxing them. It became a comprehensive amendment. A main difference under mining is that the State taxes sand and gravel operations, while the cities find that to be a retail classification. She discussed printing, and rental of real property. The Model City Tax Code taxes rental, leasing or licensing for use of commercial and residential property located within the city/town limits, although there are options to exempt this activity included. The State does not tax this activity.

Representative Daniels asked how many cities exempt rental of real property. Ms. Connolly said she can think of only one that exempts commercial leases, but there are quite a few that exempt rental leases. The State code does not tax licensing for use. There are a variety of differences under retail, depending on nexus. She noted that 67 towns tax food. Representative Daniels commented that taxing food by the State is considered regressive, but if it is done by the cities and town, it is not regressive, and added she cannot understand that.

Senator Cunningham stated the tax is regressive irrespective of the jurisdiction that imposes it. Representative Daniels said she agreed completely, but she would not take it away from the cities and towns. Ms. Connolly said it is an issue that is coming up locally in some jurisdictions and one the League thinks should be settled.

Ms. Connolly noted under telecommunications the cities tax alarm monitoring, cable television and access fees to a telecommunication network. The State is silent on nexus for mobile telecommunications services, which is specified in the Model City Tax Code. Ms. Connolly noted many cities do not have a use tax, and it has become an issue relating to utilities. Some jurisdictions have made a decision not to have a use tax, although it is an option. The same exemptions which apply to retail apply to the use tax. There is a floor on the Model City Tax Code and the first \$1,000 is not subject to the use tax. She noted the State made major changes on taxing utilities in 1998, and the cities are working with the utilities to adopt a similar tax, however, the lack of a use tax in some cities has created problems.

Ms. Connolly stated that the League had also been asked to provide a listing of unique provisions by city. There is a single page document included in her presentation. For the information packets for the business community, so they can have a single reference, they are included in the "green" pages on each city.

Representative Daniels said that when she first sent out the letters asking for information from the cities, she wanted to know where they vary from city to city or where they vary from city to state, and was told she could not ask that of the cities

because they do not know. She pointed out that she, as a small business owner with branches in four different cities, will face a variety of taxing issues. If the cities do not know how they vary, how is the small business owner supposed to know how each jurisdiction is different. She said it was wonderful that the League can provide that information.

Mr. McCarthy said the panel would hear testimony as to how each community requested various items and various people to sit on the Commission. He said the provisions were not what the cities were desiring, and they were forced to accept these items from the business community which the Legislature created and allows to exist. He said the cities would like to see it changed.

Mr. McCarthy stated that the differences in the codes were the result of the cities underlying concern over pre-emption by the State. The fact that cities have their own base maintains the integrity of the sales tax. He said in hearing the list of differences, he found very few that had anything to do with exemptions.

Ms. Connolly stated that the tax bases were substantially the same in the early 1970's and the cities "kept hold" of the taxation while the State let go of it. She referred to a document which DOR had prepared which lists all of the exemptions the State has. Ms. Connolly said she felt the current tax code has been formed by both fear of pre-emption and the cities wanting to hang on to their exclusiveness.

Representative McGibbon said he represents parts of three counties. He said he would like to discuss economic development and the problems of tax bases when moving from one county to another. One of the most frequent things which people from the southern counties ask is to help them get started. He tells them one of the most crucial things people need to study is the tax consequence. He felt it would be to the best interest of everyone to have a "level playing field," as well as to DOR and the State. He wondered why DOR had allowed so many exemptions and had not worked to solidify the taxes and present communication and uniformity.

Ms. Connolly said there is a difference of philosophy regarding taxes. City councils feel very strongly they need to have local authority. Regarding economic development, she said she feels the first thing people look at is quality of life, and sales tax revenues are critical to the quality of life issues, i.e., transit systems, schools, police and fire departments and recreational facilities. She said the cities believe they help with the wonderful economy that the State has today. Ms. Connolly noted that up to 40% of the cities' general fund revenue is sales tax, and that is a huge amount to have under the control of someone other than the city.

Responding to Representative Daniels, Ms. Connolly said the Model City Tax Code Commission must approve changes the cities want to make in the Code. The Commission gives the cities flexibility to address local problems.

Representative Daniels stated if there were a tax uniformity level at the State level, there would still be flexibility in that; the laws do not have to be rigid. She just wants the playing field to be level enough that the average business person knows what it is.

Ms. Connolly said the Model City Tax Code still remains and the cities determine what it is going to include, which maintains a great deal of autonomy. She said the State wants the cities to trust it, but they have seen what the State exempts, and they have a philosophical problem with giving up control over so much money.

Representative Daniels stated that would never change, but the cities must now trust the Commission, which is made up of seven people rather than 87. She said for the last three years the members of the Way and Means Committee have seen requests for very few tax exemptions and feels they need to be done away with. The current Legislature is not inclined to give sales tax exemptions.

Mr. McCarthy stated when talking about city control, one is no longer talking about individual city control. The old model of city councils controlling their tax base is gone; it is a matter of the cities in totality under the Model City Tax Code.

Ms. Connolly said when the Model City Tax Code was adopted, the cities agreed to give up some local authority. The Tax Code is still in place, and the fact that any changes to the Tax Code have to go through the Commission, only restricts future changes. It does not restrict the ability of jurisdictions to operate within the Model City Tax Code, which does provide more flexibility than the State code. They can keep the choices already made.

TAPE 1 SIDE B

Mr. McCarthy said it is important to understand the difference, and that the situation under discussion is the principal versus the practical application of how cities are operating. Ms. Connolly said the cities are being asked to trade the Commission for the Legislature. Mr. McCarthy said the discussion does not mean local city authority will be traded for statute. That is different than putting it in law, and does not compare to the transition of cities from individuality to the Model City Tax Code.

Ms. Connolly stated that was a voluntary giving up of authority, and there is a difference between a tax code that was created by the cities and having a Commission that listens to proposed changes, and giving up control over the entire base.

Representative Daniels stated that when the cities agreed to do that, there was nothing legally binding that made them accept the Code. Ms. Connolly agreed, but indicated that the cities and towns had complied. Representative Daniels noted there are exemptions on both sides, i.e., the City of Chandler taxing manufacturing and chemicals differently from every other city or town. They are not always in the taxpayer's favor.

Mayor Scruggs asked to revisit the tax issued raised by Representative McGibbon. She said just as the cities have no authority to refuse to accept a zoning application, no

matter how onerous, and the Commission cannot refuse to give a municipality a hearing. She noted that in September an hour and a half had been spent hearing the City of Tucson and its utility taxation problem. Mayor Scruggs said that the City of Tucson clearly understood that what it is doing needs to be rethought, and was turned away. She said it is still on the table but only until Tucson can reach a settlement with the utilities community. The Commission has to hear these items because there is a request, it does not mean the Commission will approve them.

Ms. Scruggs said the subject of the cities' philosophy being different from the State in regard to economic development was covered by Ms. Connolly. She stated that as the Mayor of one of the two cities being considered by what will become the largest employer in the State, U.S.A.A. Insurance, she knows what their perspective is on what draws a company to an area. She stated that at no time did the City of Glendale's sales tax rate nor its difference in application in various areas become an issue. The issues were what Glendale could offer them in terms of roads, traffic signals, a nice environment, landscaping, rights-of-way, parks and events for the employees. They were more interested in the quality-of-life items. She noted that the sales tax base is important to Glendale for economic development because it ensures what the city can offer to a company for its employees.

Representative Daniels pointed out that an insurance company will not be adding to the sales tax base, but pays premium tax through the State. She said it is a different revenue stream.

Mayor Scruggs responded that the employees of that company have to pay sales tax on items purchased in the community. She noted that Glendale recently held a three-hour public workshop on television and the Internet regarding the general issue of sales tax and what the rates are. The City asked the public what they value most - what they gain in benefits and services, or the money they save. She added that the food tax was a focus of the survey, and that the average family of four will spend \$25 to \$35 per year in sales tax on food. Mayor Scruggs noted that Glendale residents have the ability to have their children enter a free recreation program after school, where they can stay until 6:00 p.m. and all day every day during the summer. It was found they valued that service more than the \$25 to \$35 per year they would save. Mayor Scruggs commented the biggest part of the debate about the tax code is the issue of "one-stop shopping for exemptions." She agreed that the cities do not have total control, but neither do they have the ability for one action to take away 10% of the revenue used to run their cities. She added that is a concern.

Representative Daniels stated she understands that issue, and emphasized there is no stronger lobby than the municipalities. She said that long before an issue came up that would remove 10% of the municipalities income, she would vow not to pass such a measure. She reminded them she wants this issue to be revenue neutral. Representative Daniels stated that quality-of-life issues are very important.

Representative Valadez addressed Ms. Connolly and asked if the municipalities had deviated from recommendations of the Tax Code Commission. Ms. Connolly stated that all the cities and towns have adopted all the amendments that have been recommended to date.

Representative Daniels questioned that every city and town has adopted the recommendations of the Commission since 1986. She mentioned the taxation of the smelter in the Town of Hayden. Ms. Connolly said the Town of Hayden was operating within the context of the Model City Tax Code. Representative Daniels noted they did not have anything to say about the tax. Ms. Connolly stated the tax that Hayden was considering was not a new tax, but was existing and had been in the Model City Tax Code since the beginning. Hayden is the only town with a smelter, and the real issue was increasing the rate on mining.

Representative Valadez asked if the Commission has changed any provisions retrogressively. Ms. Connolly said there have been retroactive tax exemptions, but no retroactive applications.

Representative Valadez said that one idea proposed by Mr. McCarthy was to codify the Model City Tax Code into statute. He asked if that were done, could Ms. Connolly envision the Legislature making retroactive changes to the Tax Code.

Ms. Connolly replied that is the basis of the cities and towns concern. Once the Tax Code is put into statute, it is fair game for every legislative session. A city council could be working on its budget only to find out that something it planned to gain tax revenue from will not be there anymore. She said it is wonderful for the Legislature to say it does not want to hurt the cities financially, but reminded the Committee that there will be successors, as many members have reached their term limit. She said it is an issue of control.

Representative Valadez asked what, in terms of the options that exist within the Model City Tax Code, the purpose of those options is and are they a matter of economic development. Ms. Connolly said there was no single reason, some are economic development, others are because of a dominant industry or how the town thought something would work best.

Representative Valadez asked if she would equate the State's desire to codify the Model City Tax Code to the federal government doing something similar to the State and not allowing it to have tax incentives. Ms. Connolly said that did occur to her.

Senator Cunningham said he would like to give a different perspective to Representative Daniels saying there is no stronger lobby than the municipalities. He said he feels the Arizona Chamber of Commerce, the Salt River Project (SRP), Arizona Public Service (APS) and ATRA are the "800-pound gorillas." He continued to say the cities lobbying efforts "look like a chimpanzee" in comparison.

Senator Cunningham said he would like to discuss the idea of revenue neutrality. He said he thinks the cities should provide the Legislature with how much additional revenue would not be realized if the State's sales tax base was what they were allowed to enact.

Representative Daniels countered that had never been her intent in promoting this issue. Senator Cunningham stated it is the concern of the cities and rather than going into "reality denial" that that is not where the Legislature would go after a few years, let the Committee see what the outside risk is. He said from that point something may be worked out, including, perhaps, an increase in revenue sharing. Senator Cunningham said perhaps the cities could be "bought out" of their autonomy. He asserted that is what happened when they were offered revenue sharing instead of income tax revenues.

Representative Valadez pointed out that he asked the City of Tempe to project those figures, and they alone would lose \$18.9 million per year.

Representative Daniels asked what the total budget for the City of Tempe is. She stated that when the commercial lease tax was repealed, the cities were allowed to continue the commercial lease tax, but had they been pre-empted the City of Tempe would have lost less than 1/10 of 1%. She said the numbers have to be viewed in a broad base and everything has to be considered.

Representative Valadez commented "this Legislative body whines and disagrees about amounts in ten of thousands of dollars. Here we are talking about amounts of \$20 million in a considerably smaller budget."

Mr. McCarthy said he did not believe he has seen legislation drafted that does what is being discussed. The issue is who has control over the tax base. If a bill is drafted which puts the entire Model City Tax Code into statute, it will be vigorously opposed. He emphasized it has little to do with what the Committee is talking about other than allowing people to mislead what is being discussed. It has never been about taking away the cities abilities to tax food or certain rents.

Mayor Scruggs said the appropriate question is not what percent of the budget is lost, but what percent of the unrestricted fund is lost. Some of the funds are totally restricted and this would not be applicable. She asked that, as discussions proceed, the amount that would be lost be matched to the monies that are not already allocated to fix the streets, etc.

Representative Daniels told Ms. Connolly that if she wished to prepare such a comparison, as requested by Senator Cunningham, that she could. She emphasized that is not "the road she is going down," and that it has never been her intent.

Senator Cunningham commented that policy changes must come in stages. Since the Model City Tax Code is not in statute, the prospect of offering legislation which will

further conform cities and restrict their base is not occurring. However, if it is placed into the statute, within a few years bills will be started to disallow one thing or another, some of which may have been good tax incentives for various industries. He said he respectfully disagrees, but the situation is about money and what the cities stand to lose as part of the revenue that is available to the community. Any discussion without that aspect is not an honest discussion of the issues.

TAXPAYER PERSPECTIVES

Barb Dickerson, Director of State and Local Tax for Arthur Anderson, and Chair of the ATRA Practitioner Committee, said since the agreement of the Model City Tax Code, there has been progress in getting conformity with the State provisions in the areas of machinery and equipment. She said she believes that the passage of H.B. 2193 last year, with requirements on the Tax Code Commission, will continue to ease the administrative burdens on the business community in the State.

Ms. Dickerson presented the idea of how confusing it is to a business person trying to work within the confines of a municipal tax code that is different from the State code. She said ATRA deals with businesses that are resident in the State and businesses throughout the country who are trying to comply with the variances that do not exist in most states. Ms. Dickerson noted there are "real traps" for the unaware in the Model City Tax Code. The first one is the city tax on speculative building. She supposed there is a small business which has just built a building, and then is approached by another company which desires to acquire the first company. If that occurs twelve months after the certificate of occupancy was issued on that building, the small business person will be deemed to be a speculative builder and the tax will be on the value of the real property improvements including land and any inflated value to it. She said ATRA is asked if Arizona has a real estate transfer tax, and stated it is only \$2.00, but will warn a business it has to be careful about the tax on speculative buildings because it is kin to the transfer tax. Ms. Dickerson cited several other examples. Financial arrangements called sale-lease backs are those where a building is built, immediately sold and leased back for financing purposes, and are subject to the speculative tax. Ms. Dickerson said there is disagreement between the cities as to what triggers a tax, so the business person trying to make decisions can be hurt by the tax on speculative building. In the Code, it falls under contracting, and most people would not think to look in that section to see if a tax affects them.

Ms. Dickerson mentioned licensing for the use of real property. She used the example of a small business which has a public phone on its property, and receives commissions from the telephone company; that commission is subject to tax. She said it has never existed at the State level. She also said parking is taxable if you charge the employees for parking.

Ms. Dickerson discussed the conformity of the cities to the Model City Tax Code. She said she disagrees that the cities always comply, and that Chandler is the biggest offender. It does not conform to the machinery and equipment exemption for research

and development even though every other city does. These are things which catch people unaware. Ms. Dickerson discussed the e-commerce issue, and said that Chandler is attempting to tax web-hosting services under a local advertising tax. Most web-design businesses are small businesses, and if they do not remove the hosting from the web design that will be taxed.

She said her point is that there is a long way to go before the Model City Tax Code is workable and eases the burden on the business community. Businesses who operate in multiple jurisdictions are faced with audits by the State and the jurisdictions in which they reside. A company can face one audit after the other. The effort to comply, know and not be caught unaware by the differences of the State code and the Model City Code are significant and need to be addressed.

Mr. McCarthy assumed he owned a medium-size business desirous of locating in Arizona, and wondered if he should ask the city what the difference is between the sales tax base of the city and the State and the national rates. Ms. Dickerson said if the business is coming from another state, it will probably not know to ask that question. She said they may not know enough to ask if there are differences between the city of choice for its operation and other cities.

Mr. McCarthy said once the small businessman has learned his liability with the city of choice, and has the tax exposure accomplished, how would he know when it is going to change. He suggested going to the Arizona Revised Statutes but wondered how he would know on the city level. Ms. Dickerson said the only way to really know is to subscribe to the Model City Tax Code through the League of Arizona Cities and Towns, which is updated quarterly. A typical technical resource will not provide that information.

Mr. McCarthy said people need to remember there are benefits in the cities which are reflected in the great jobs they have done in protecting their authority on a variety of things. However, the downside can be that a taxpayer will not know when the Tax Commission meets to change his liability. He noted that at least everyone knows when the Legislature meets and can send someone to watch; that is not the case in the municipal tax system. He said businesses need to hope that someone finds out about a meeting and notifies them. Mr. McCarthy said the "notion that taxpayers have it good here with the Model City Tax Code, not only is not true, but as a matter of policy, is not fair to people, and the due process leaves something to be desired."

Mayor Scruggs said initially that before a change can take place in the city there has to be public notification and public hearings. Those businesses that would be affected are mailed notices and there would be no surprise within the community. She said, with regard to the secret meetings of the Municipal Tax Code, of which she has been a member for about two years, the meetings have been specific to large industries, and long before it comes to the Commission, the League has been working with the industries to solve the issues. Before change can take effect, it has to be adopted by the community, which goes through the public hearing process. Mayor Scruggs said she would collect additional information on the process and mail it to each member of

the Committee, but asked that they be cognizant of what goes on in cities and towns. She noted that most cities have populations of under 25,000, and there is no secrecy. The affect of the large businesses is placed on only 5% of the population and their needs are specific to that industry. Mayor Scruggs noted there is plenty of public information available. She noted that 50% of Glendale's assessments are given back in refunds.

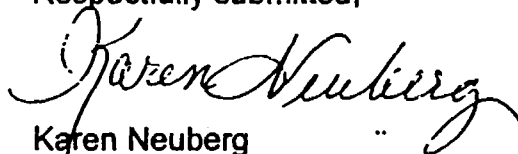
Mr. McCarthy said this type of due process may very well go on in Glendale after the Model City Tax Commission has met. He said cities do not have to go through that process to get something on the Model City Tax Commission's agenda, and that this summer there was a meeting he was not aware of, and he is "plugged into the process." He said it is one thing to be sitting on the cities' side of the fence, protecting their own tax bases, but on the other side where the liability is, there is an entity that can meet at any scheduled time and change your liability. He said this Committee is questioning what the benefit of this Commission is to the cities and the State. If the benefit is so great that it is to the detriment of good tax policy, then that should be the topic of discussion.

Representative Daniels stated she is postponing the Department of Revenue's presentation until the next meeting, and that notification of that meeting will be forthcoming.

Barry Aarons, Senior Fellow for Americans for Tax Reform, had signed up to speak, but said he would be happy to defer his comments until the next meeting.

There being no further business, the meeting adjourned at 11:58 a.m.

Respectfully submitted,


Karen Neuberg
Committee Secretary

(Tapes and attachments on file in the Secretary of the Senate's Office.)

ARIZONA STATE LEGISLATURE

Interim Meeting Notice

Open to the Public

Uniform Transaction Privilege Tax Study Committee

DATE: Tuesday, October 26, 1999

TIME: 10:00 a.m.

PLACE: Senate Hearing Room 3

AGENDA

I Opening Remarks

II Presentations:

(a) Staff Presentation – Background Information

(b) State & Model City Tax Code Comparison – Arizona League of Cities and Towns

(c) Taxpayer Perspectives

(d) Joint Audit Program – Department of Revenue

III Public Comment

IV Committee Business

V Adjournment

MEMBERS: (See Attached)

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10/7/1999

People with disabilities may request reasonable accommodations such as interpreters, alternative formats, or assistance with physical accessibility. If you require accommodations, please contact the Chief Clerk's Office at (602) 542-3032, (TDD) 542-6241.

MEMBERS:

- | | |
|--|---|
| ✓ Senator Scott Bundgaard, Co-Chair | ✓ Representative Lori Daniels, Co-Chair |
| Senator Ken Bennett | ✓ Representative Bill McGibbon |
| ✓ Senator George Cunningham | ✓ Representative Ramon Valadez |
| ✓ Mr. Kevin McCarthy, Arizona Tax Research Association | |
| ✓ Ms. Tami Ryall, Town of Gilbert | |
| ✓ Mayor Elaine Scruggs, City of Glendale | |
| Ms. Kathy Turken, Turken Industrial Properties | |

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10/7/1999

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ARIZONA STATE LEGISLATURE
Forty-fourth Legislature – First Regular Session

**UNIFORM TRANSACTION PRIVILEGE TAX STUDY
COMMITTEE**

Minutes of Meeting
Monday, November 8, 1999
Senate Appropriations Room 109 – 10:00 a.m.

Cochairman Daniels called the meeting to order at 10:10 a.m.

Members Present

Senator Scott Bungaard, Cochair
Senator Ken Bennett
Senator George Cunningham
Mr. Kevin McCarthy
Ms. Tami Ryall

Representative Lori Daniels, Cochair
Representative Bill McGibbon
Representative Ramon Valadez
Mayor Elaine Scruggs
Ms. Kathy Turken

Speakers Present

Vince Perez, Legislative Liaison, Department of Revenue
Donita Plaumann, City Program Manager, Department of Revenue
Melody Jones, Research Analyst, Ways and Means Committee
Charles Rochman, New Media Director, Tucson Newspapers
Debi Weeks, Finance Manager, Evergreen Internet
Ann Dumenil, Attorney, Jennings, Strouss and Salmon
Barry Aarons, Senior Fellow, Americans for Tax Reform

(Tape 1, Side A)

Presentation by Department of Revenue

Vince Perez, Legislative Liaison, Department of Revenue, discussed the memo dated October 6, 1999, (Attachment 1), which he sent to Representative Daniels and Senator Bungaard prior to today's hearing. Mr. Perez addressed the few main points in the memo as follows:

- The Department of Revenue (DOR) has a Program City Manager who acts as staff to the Municipal Tax Code Commission.

- This manager provides information to the Commission regarding complex audit issues, court cases, audit procedures and general ongoings of the department.
- All program cities and towns provide the DOR with a copy of any ordinance changes regarding the city tax code or city tax rate and then DOR sends out the notification to all tax payers that are effected.
- The City Program Manager of DOR meets with program cities as well as non-program cities regarding large multi-jurisdictional audits in an effort to avoid multi auditor visits to tax payers.

Mr. Perez gave a brief overview of recent audits and stated the following:

- For fiscal year 1995-96, 621 audits were performed, totaling just over 1.8 million dollars.
- For fiscal year 1996-97, 712 audits totaled over 1.8 million dollars.
- For fiscal 1997-98, 435 audits performed and totaled just over 1.5 million dollars.
- And in fiscal year 1998-99, 471 audits were performed totaling just over 1.4 million dollars.
- The average is 560 audits per year for the program cities, totaling just over 1.65 million on an average.

In response to inquiry from Representative Daniels regarding the time involved in conducting an audit, Mr. Perez explained that approximately ten years ago, DOR was at roughly 40 hours per audit and that currently, the program cities take approximately 20 hours to complete. He stated that in addition to the audits, various programs such as billings, take the place of sending out auditors and over the past six fiscal years, the department averaged just under one-thousand billings, totaling about \$240,000 per year. In response to inquiry from Representative Daniels as to whether or not those billings included penalties and interest, Mr. Perez stated that they are current billings only.

Mr. Perez discussed the food codes and stated that there are three cities that have separate class codes for food, which allows for tracking of the tax dollars generated from the sales of food. He gave the following summary of the total tax dollars generated from the sales of food:

- Fiscal years 1995-96 there were two cities with class codes, which totaled \$128,688.
- Fiscal year 1996-97, the total was \$138,617.
- Fiscal year 1997-98, the total was \$163,803.
- Fiscal year 1998-99, the city of Patagonia was added 1/1/99 totaling \$1,333,537.

In response to inquiry from Kevin McCarthy regarding multiple audits, Mr. Perez explained that generally what happens at the beginning of each fiscal year is the group gets together and determines who will conduct audits on which companies. Generally, this only pertains to large companies so there is not a lot of interaction with the smaller companies. The state will sit down with the program or non-program cities to detail the audit information.

Donita Plaumann, City Program Manager, Department of Revenue, responded to inquiry from Mr. McCarthy and explained that the unified audit committee meets at the first of each fiscal year to compare audits scheduled for the coming year. She explained that the cities work with the DOR in a coordinated effort to match up audits so that they are not conducting audits at the same place at the same time. She explained that, if there is a match, then it is determined who will conduct the audit. When a city conducts an audit for DOR, they also take on the responsibility of conducting it for any program cities that may be a part of that audit. In addition, throughout the year, often times DOR will learn that their auditors will be at one location at the same time and the tax payer will make a request that only one of the auditors be there. The appropriate city for the DOR is contacted and DOR offers to conduct the audit on their behalf.

In response to inquiry from Mr. McCarthy, Ms. Plaumann explained that DOR does not take the entire audit base, but rather the larger ones. She stated that it can happen, and has happened, that DOR is almost finished with an audit and then the next city will request to schedule an appointment. She added that this is not part of their matching process but that these are audits for smaller companies.

In response to inquiry from Representative Daniels, Ms. Plaumann explained the criteria of the DOR when selecting the companies to be matched.

Representative Daniels asked about the size of the companies that are matched. Ms. Plaumann explained that the Department of Revenue's criteria for selecting the companies is called "Over Five", and it pertains to companies that pay over \$500,000 per year in taxes. Representative Daniels then asked how many companies are subsidized at the beginning of the fiscal year and how many come up during the course of the year that did not fall into the "match-up" category. Ms. Plaumann stated that she has no way of answering that question because sometimes it takes as long as two years to get an appointment, especially with the very large companies. Mr. Perez stated that he would get that information for Representative Daniels.

Mr. McCarthy asked if the taxpayer is ever offered an opportunity to select the agency to conduct the audit. Ms. Plaumann explained that if the taxpayers make the request, the DOR works very hard to make it a possibility. Mr. McCarthy inquired about the education process that the auditors are involved in and who conducts them. Mr. Perez explained that the instruction is done through Department of Revenue at various levels. A training section handles general training and specific knowledgeable people in various fields who train other auditors in those fields, as well as on the job training.

Mayor Elaine Scruggs pointed out the following:

- When a company is not included in the match system, that there is no communication that there is an audit that will be conducted.

- It may take up to two years from the time a request is made for an appointment to actually begin the audit. Another possibility for the audit overlap is because the city thought it happened two years prior.
- When the audit is completed, is there also no communication sent stating that an audit is completed?

Ms. Plaumann explained that the Unified Audit Committee meets every two months. She stated that there is an inter-governmental agreement and that information is shared regarding which audits have been completed, how the assessments were made and the classification of the assessment. There is an exchange of information and everyone knows who has done what. Mayor Scruggs asked if there is also information shared as to what audits have just begun. Ms. Plaumann explained that usually discussion is with respect to completed audits. However, discussion regarding audits in progress does take place with a unique issue.

Representative Daniels asked how long the typical audit takes to complete. Mr. Perez explained that, on an average, an audit could take from eight months to one year.

In response to inquiry from Mr. McCarthy, Ms. Plaumann explained that of the twelve non-program cities, Nogales is the only one that does not participate in the meetings. She added that there are a few other program cities that are listed on the membership who attend as well.

Staff Update

Melody Jones, Research Analyst, Ways and Means Committee stated that she distributed to the Committee the Responses to TPT Administration and Audit Questions (Attachment 2). She explained that this information regarding Tucson has been revised. She pointed out that there is a range that reflects audit time from eight hours to 40 to 50 hours. Ms. Jones pointed out the following:

- The major revenue sources include the urban revenue sharing or state income tax, transaction privilege tax distribution from the state and distribution from the vehicle license tax.
- The major revenue sources, the urban revenue sharing, transaction privilege and distribution from vehicle license, go to the cities general fund and are for general purposes.

Ms. Jones pointed out that the population reflected on the handout is the population that is currently used for distribution purposes. She stated that it is the 1990 census so it should be noted that there are cities that have significant lower population than they would currently have.

(Tape 1, Side B)

Testimony of Charles Rochman

Charles Rochman, New Media Director, Tucson Newspapers explained that he provides Internet access for about 13,000 customers in the Tucson area. Mr. Rochman stated that he is currently in a dispute with the City of Tucson regarding sales tax on his approximately \$20 per month access charge. Mr. Rochman described the confusion created when the city attempts to create tax revenues out of sources that the State of Arizona and the federal government have decided should not be subject to taxation and pointed out the four main components of the internet access he sells.

Mr. Rochman discussed the four main components of his Internet access business as follows:

1. Phone lines to handle incoming calls from customers. He explained that this is significant portion of the cost incurred to his business. He buys the service from MCI Worlcom in Tucson and is charged federal access charges, state sales taxes, city sales taxes and a special City of Tucson 2% franchise fee on those services. In total, the tax on the phone bill exceeds 20% of the whole bill and to pay another 2% would be excessive.
2. Phone lines to carry the digital traffic to and from the Internet. He explained that most of this traffic, but not all of it, is interstate because most of the web sites of interest are outside the State of Arizona. This service is bought from GFP Savage and Ace's Research and are charged the various communication taxes.
3. Equipment - He explained that modems, servers and routers are needed to handle the Internet traffic. The equipment receives calls, serves up web pages and e-mail and routes the internet traffic to its intended destination and back and, again, most of that is probably interstate. The equipment is not exempt from sales tax when it is bought and it is not classified as related to any production processes or any exempt telecommunications equipment categories.
4. Customer support. He stated that his company provides extensive customer support services which includes assistance with their computers, their modems, their operating systems, their browsers and their e-mail clients.

Mr. Rochman stated that historically, system support services have not been subject to city taxation and are noticeably absent from the city code. He expressed his opinion that the city is abusing its taxing power by imposing layers of multiple taxation upon Starnet and its customers and even imposing tax on the non-taxable service income.

Mr. Rochman pointed out the following:

- The State of Arizona does not levy its sales tax on Internet service providers. However, the City of Tucson does levy such a tax claiming that Internet access is a taxable telecommunications service in accordance with section 19-470 of the Tucson code. He stated that the commerce clause of the U.S. Constitution gives the federal government exclusive powers over interstate commerce, including the power to tax interstate commerce. After discussion regarding how an Internet connection operates, the Arizona Department of Revenue concluded that information received via the Internet was predominantly interstate and international.
- Arizona Revised Statutes section 42-6004 also restricts the local governments ability to tax interstate telecommunications services. However, the City of Tucson gets around this by attempting to tax interstate transmission subdigital information such as web pages and e-mail, by calling it access to a telecommunication service. This distinction between transmission and access is one that the City of Tucson makes, but the State of Arizona makes no such distinction in its tax code.
- The city tax code does not specifically define the phrases *Internet services* or *access to a telecommunication service system*. However, it wants to charge taxes on this service and compares this service to hotel surcharges on long distance telephone calls or a burglar alarm service.
- He pointed out that it is a well-established rule in Arizona that ambiguous tax statutes should be liberally construed in favor of taxpayers and strictly construed against taxing authorities.

In summary, Mr. Rochman stated that the City of Tucson wants to tax Starnet for services that it has not defined and has not properly characterized. The City of Tucson chooses to do so despite the fact that Starnet is taxed many times at the wholesale level and chooses to do this in defiance of federal restrictions on interstate transmission and even while Arizona concludes that this is a service not subject to telephone communication services.

In response to inquiry from Mr. McCarthy, Mr. Rochman explained that this information did surface in both the State of Arizona audit and the City of Tucson audit. He added that before he was managing the internet business, he was controller at Tucson Newspapers for five years and, while the state did not audit as much as the city with respect to sales taxes, he believed that they were never made aware of the choice not to have two audits.

Testimony of Debi Weeks

Debi Weeks, Finance Manager, Evergreen Internet, gave a brief history of her company and explained that they provide programming services, internet website design, development services and website hosting, as well as access to the internet and more recently, her company is focusing on software development.

She stated that the City of Chandler is trying to tax her Internet design and development service and website hosting services. She explained that in the last couple of months, the City of Chandler began auditing her company and they are trying to impose city sales tax under its local advertising classification on her internet website hosting services, website design and development services. She explained that historically, the city sales tax has been limited to advertising on billboards, local radio and local television stations. Ms. Weeks stated that putting a webpage on the World Wide Web, which is not only national but also global, should not constitute local advertising in Chandler. She added that one of the main concerns at Evergreen is that during the audits, she learned that the City of Chandler plans on going retroactive with their taxation based on a new position.

Ms. Weeks explained that when she started her company in Chandler, she wrote to the city and although she clearly described her business, she never received clarification regarding city tax liability. She said that the new interpretation is grossly unfair and if it becomes retroactive, the city will tax a large sum of money, which will include fees and penalties. Ms. Weeks explained that she was told that every bit of revenue collected since the business moved into Chandler will be taxed and late fees and penalties will be applied. She stated that it is too late for her to try to collect taxes from her clients on previous transactions and this hit will definitely be a hardship to her business. Ms. Weeks offered the recommendation that the committee prohibits Arizona cities from taxing Internet access fees, Internet website design and development services and website hosting services and to help prevent Arizona cities from imposing a retroactive tax based on a new interpretation.

Testimony of Ann Dumenil

Ann Dumenil, Attorney, Jennings, Strauss and Salmon, gave a brief summary of her professional background. She stated that the last legislation study committee came out with the following two recommendations:

1. To try to reduce the differences between the state and city tax codes.
2. To reduce the variations among the various city tax codes.

She stated that the model city tax code that was initially adopted did not reduce the differences between city and state sales taxation. Instead, it magnified those differences. She explained that prior to the 1987 model city tax code, most of the city sales tax codes were patterned after the state law. They employed the same language and had the same definition. However, when the city taxing officials wrote the city tax code, they ignored the language and created an entirely new tax code which uses new language regarding what activity is taxable. This new tax code created substantially greater differences between state and municipal taxation, rather than try to eliminate those differences.

Ms. Dumeril discussed the problems that exist in trying to comply with the various city tax codes.

- Compliance with the various codes. In the State of Arizona, there is one state sales tax code plus 87 different city sales tax codes. Trying to comply with the various codes is costly and time consuming for business' to learn about the differences, as well as train their employees about those differences.
- Lack of uniformity. Each city can have their own interpretation of the city tax code. The Unified Audit Committee could not have an agreement among the city taxing officials, which led to this lack of consistency and uniformity among the cities.
- Multiple licensing and filing requirements. This is also costly and time consuming for businesses.
- Taxing jurisdiction. The model code reflects several factors regarding claiming tax, such as, warehouse location, buyer location, where the transaction took place, where the product was shipped, etc. so there is a problem with respect to who can tax these transactions. There are numerous city audits because several cities want to tax the same transaction.
- Retroactive Application of New Interpretations. This can be extremely costly to a business when the city tries to collect retroactive taxes, penalties and interest because of new interpretation.

(Tape 2, Side A)

Ms. Dumenil discussed multiple audits and pointed out that there is no single forum for appealing multiple city audits. She discussed the steps involved in trying to appeal a multiple audit and pointed out that there needs to be some sort of uniform appeal process.

She concluded by pointing out that of forty-seven of our states, there is one tax code, one set of regulations of rules and one set of interpretation for complying with state and local sales and use tax requirements. Arizona's system with one state law and 87 different city sales tax codes and the multiple variations and exemptions and interpretations for state and local sales and use tax purposes is incredibly poor tax policy. It is very costly for business to comply with. Also, it is an incredible waste of taxpayers dollars.

In response to inquiry from Senator Cunningham regarding examples of how the model city tax code greatly expanded the difference between the state and local tax use, Ms. Dumeril pointed out some of the changes with the adoption of the model code in 1987:

- The state tax rental of real property was expanded to rental and licensing.
- Under the speculative builder class under both state and city levels, there were deductions for land in all but one city. Upon adoption of the model city tax code, all cities now tax land sales.
- The use tax at the state level is on purchases of tangible property. The model city tax code expanded that to include rental of tangible property as well as purchase.

She added that 90% of the differences arise from the creation of the new language in the model city tax code.

Senator Bennett asked for clarification regarding the reduction of the number of exemptions. Ms. Dumeril stated that although some of the exemptions have been added back in, they have narrowed the availability of the exemptions. She added that from a tax policy standpoint, it is preferable to have a simpler tax system. The simpler it is, the easier for business' to comply with and the greater compliance, the less problems and audits.

Testimony of Barry Aarons

Barry Aarons, Senior Fellow, Americans for Tax Reform, gave a brief description of his history in this issue and explained that he was on the first model city tax code commission and participated in the negotiations that ultimately led to the model city tax code. He discussed consumption tax uniformity and stated the reasons for uniformity have changed but the need has not. He pointed out that compliance in taxes is one of the clearest facts for small not being able to survive. The cities should not tax for the purpose of gaining revenue that will result in an actual reduction of revenue because capital formation will be affected in a negative way and jobs creation will be reduced. He suggested that the committee consider as part of its recommendation, Senator McCain's SB 1611 or Congressman Cox and Senator Widen's bill, which is similar regarding the moratorium on Internet taxation.

Discussion

In response to inquiry from Senator Bennett, Mr. Aarons stated that policy should be made to enhance E-commerce to be flourishing. Senator Bennett stated that the same tax policy should not give one type of delivery transaction a more favorable tax treatment than another and should equally enhance all of them. Senator Bennett agreed that Arizona does need simplicity and uniformity and at the same time, needs to balance out with local control.

Mayor Scruggs agreed with Senator Bennett's comments and pointed out that many small businesses were being left out. To that point, Representative Daniels pointed out that competition is part of the understanding that people have when they do go into business. However, there are many other issues involved and her recommendations go to the fact that there are problems with the status quo because it is not working. She urged the committee for some ideas and recommendations.

(Tape 3, Side A)

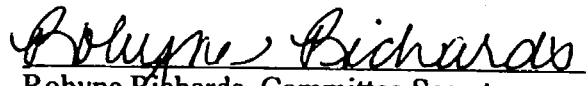
Mayor Scruggs commented regarding the recommendation to "throw the system out" with no thought whatsoever to consequences. She pointed out that residents as well as businesses would feel the effects. She noted that her staff had compiled a book for the committee and asked it be part of this committee's process.

Representative Daniels stated that she ran a sales tax uniformity bill in this state for five years and in all that time, it has never tried to make the model city tax code commission equal to the states. She added that the code should not be thrown out. However, the status quo is not working.

She pointed out that the model city tax code commission is sunset for next year. She stated that audits through the appeals process, definition and interpretations in the model city tax codes that might adhere somewhat more to the state or at least an interpretation within 87 cities.

She added that her intent is to be revenue neutral and make a difference with the business community. Her goal is not to financially devastate any city. She asked that the cities come forward with any recommendations at the next meeting.

Without further objection, the meeting adjourned at 11:40 a.m.


Robyne Richards, Committee Secretary

(Original minutes, attachments and tapes are on file in the Chief Clerk's office)

ARIZONA STATE LEGISLATURE
Forty-fourth Legislature – First Regular Session

UNIFORM TRANSACTION PRIVILEGE TAX STUDY COMMITTEE

Minutes of Meeting
Monday, December 6, 1999
Senate Hearing Room 3 – 10:00 a.m.

(Tape 1, Side A)

The meeting was called to order at 10:05 a.m. by Cochairman Daniels and attendance was noted by the secretary.

Members Present

Senator Cunningham
Kevin McCarthy
Tami Ryall
Mayor Elaine Scruggs

Representative McGibbon
Kathy Turken
Representative Valadez
Representative Daniels, Cochairman

Members Absent

Senator Bennett
Senator Bundgaard, Cochairman

Speakers Present

Cathy Connolly, League of Arizona Cities and Towns
Vince Perez, Public Information Officer, Arizona Department of Revenue (ADOR)
Barb Dickerson, Chair, Practitioners Committee, Arizona Tax Research Association (ATRA)

Guests Attending

Ann Durnenil, representing herself

Cochairman Daniels thanked the Members for serving on the Committee. She added that, hopefully, recommendations and ideas will be presented that everyone can live with. Many ideas were presented in previous meetings and the Members have heard both sides of the issue.

Public Testimony

Mayor Scruggs noted that a request was made at the last meeting for recommendations. From the testimony made before the Committee, she and others believe the local sales tax system is not

UNIFORM TRANSACTION PRIVILEGE
TAX STUDY COMMITTEE
December 6, 1999

broken, but improvements and enhancements can be made. She added that just as federal control is not the answer to many of the difficulties facing the states, State control is not the answer to the local sales tax system. She noted that the recommendations proposed by the League of Arizona Cities and Towns are substantive, some more than others, and represent a thoughtful, determined effort to address some issues and remove the whole subject as a point of contention. She reviewed the recommendations (Attachment 1).

Mayor Scruggs added that the League listened carefully to testimony before the Committee and problems encountered by the business community. The League is ready to move forward with implementation of the recommendations as soon as possible to achieve the mutual goal of uniformity and a business community that can concentrate on business and not be distracted by the difficulties of dealing with all of the entities.

Cochairman Daniels referred to the first recommendation to continue the Municipal Tax Code Commission and pointed out that a law passed last year requires cities to adhere to the Commission's requirements. She asked if the League is agreeable to that requirement.

Cathy Connolly, League of Arizona Cities and Towns, clarified that the League opposed that provision in the legislation last Session; however, as a practical matter, that is happening. The cities have either implemented the recommendations of the Commission or made necessary amendments. The preference is not to have the language in the legislation because of the local control issue, but it is currently law.

She advised Cochairman Daniels that the League has been very consistent in opposition to preemption by the State on any issue. If legislation addresses continuation of the Commission and some of the recommendations can be worked on cooperatively with businesses, the Executive Committee would probably agree to that requirement versus uniformity. However, she cannot definitely state whether or not the League would fight that portion of the bill again because of the general policy position of the organization on preemption.

Mayor Scruggs indicated that she is a Member of the Executive Board of the League and surmised that the officers would probably take the issue to the full Board for consideration. While the Board strongly supports local control, in this particular situation, there is an outward demonstration of trust that is being sought and reliance on how the cities are going to operate. She added that the Board believes very strongly in the Model City Tax Code and the Commission. As one Mayor, she believes it would be the correct action to take.

Ms. Connolly advised Mr. McGibbon that the intent is to have the single hearing officer travel. One of the points of testimony was that even though there may be a joint city audit, if a taxpayer wants to appeal the audit, an appeal is sometimes necessary in several cities. She clarified that other jurisdictions participating in a joint city audit would abide by the first ruling in a particular appeal; therefore, a taxpayer would not have to go through multiple hearing processes for a single audit for a number of jurisdictions.

She informed Mr. McCarthy that the hearing officer would be financed through a series of Intergovernmental Agreements (IGAs) among the cities. The amount each jurisdiction would

pay has not been discussed. It would probably take about a year to complete IGAs with 11 jurisdictions and hire a hearing officer.

Cochairman Daniels referred to the second recommendation requiring quarterly meetings of the Commission and asked if the League is agreeable to adding a few Legislative Members to the Commission.

Ms. Connolly indicated that the cities would be happy to entertain other membership; however, there were grave problems with the proposal from last year's sunset hearing to have the Joint Legislative Tax Committee (JLTC) become the Commission.

Cochairman Daniels said she envisioned the House and Senate Chairs of the Finance and Ways and Means Committees or designees as members. She added that JLTC has basically been abolished so that will no longer be a problem.

Mayor Scruggs commented that with Legislators, there would be 11 members on the Commission.

Cochairman Daniels responded that perhaps not every member would remain, but the makeup could be changed. Too large Committees become very unworkable.

Senator Cunningham indicated that he has no problem conceptually with adding Legislators to the Commission, but if it becomes more of a rule-making body with more power, issues arise about Legislators serving in an executive capacity. Therefore, given the new role of the Commission, Legislators may not be able to serve.

Cochairman Daniels indicated that she understands Senator Cunningham's concern, but the intent of the suggestion is to have more cohesiveness between the Commission and the State.

Senator Cunningham stated that Legislators may have to be Ex Officio members without a vote.

Mayor Scruggs related a need for a requirement that the same person attend the meetings. She explained that the Commission carries matters for a long period of time, not because decisions cannot be made, but the city and interests are usually asked to work out problems and return. A new face at each meeting could be a problem.

Cochairman Daniels replied that if the Chairs did not want to be on the Commission, one designee could be appointed for a year's term.

Senator Cunningham clarified that Legislators cannot serve on rule-making bodies, commissions, etc., because it is a violation of the Constitutional provision of separation of powers. Legislators are then into implementation and execution of the law rather than policy making.

Mr. McCarthy indicated that while ATRA would not recommend continuation of the Commission, much less for 10 years, he thought it was in place to listen to general taxpayer and city concerns. Referring to recommendation 5 under Auditing, he questioned if the cities would

be opposed to one audit, i.e., if the State first audits a taxpayer, the cities agree to the State audit serving for the State and the cities, program or non-program.

Ms. Connolly responded that there are currently technical and substantive problems with that. The substantive problem is that the State's tax base is not as broad as the city's tax base, so a State auditor could audit a taxpayer but not be conversant enough with the city tax code to be able to conduct a joint audit on city issues. She indicated that the League will work with the Arizona Department of Revenue (ADOR) on enhancing the joint city/State audit program. A few problems need to be worked out before the State could adequately audit for all of the jurisdictions.

In response to Mr. McCarthy's comment on the first recommendation about expanding the duties of the Commission, Ms. Connolly said the Commission has always accepted changes to the tax code from businesses and cities. She talked to Mayor Scruggs, Ms. Ryall, and the cities about whether or not the Commission should also be a forum for people to express concerns, for example, about Internet activities brought up at the second meeting and those kinds of items. It is a proposal to address problems that are encountered.

Mr. McCarthy said he was under the impression that the State audits for cities when performing audits. He doubts that every city that collects sales taxes has an in-house or contracted audit staff. He asked if the recommendation that all non-program city audits will be joint city audits extends to the cities in the collection system with their own contract auditors.

Ms. Connolly replied that it does not say that in the recommendation, but should, and those cities are in agreement with the recommendation.

Cochairman Daniels remarked that Ms. Connolly provided 13 pages of material for the first meeting and asked if the information can be reduced to four pages. She said she does not wish to take food tax, commercial lease tax, or any of those away from the cities, so maybe there are six or seven items that only two or three cities do that are not a huge revenue source and could be eliminated from the code. There could be a menu of options for the cities, but not such an extensive one.

Ms. Connolly responded that it is an ongoing effort; however, some jurisdictions believe the variations are unique local responses to situations encountered in their particular community and many are to the benefit of the taxpayer rather than the city. She added that variations and differences are not always the imposition of additional taxes, but many are exemptions.

Vince Perez, Public Information Officer, Arizona Department of Revenue (ADOR), testified that any time ADOR conducts an audit and the taxpayer has ongoings in a program city, ADOR will conduct the city audit unless the city has a contract auditor. ADOR would probably contact the city first to determine if they have an auditor. If not, ADOR would ask if they want the State to conduct the city audit in the course of the State audit and go from there. He acknowledged that ADOR has a process in place requiring auditors to understand the city tax code as well as the State tax code.

Barb Dickerson, Chair, Practitioners Committee, Arizona Tax Research Association (ATRA), stated that Tax Practitioners met and developed a list of recommendations for the Committee. She recognized that politics surrounding the issue are somewhat pervasive, so those developing the recommendations determined what an ideal scenario would be and made further recommendations if that scenario cannot be achieved.

- The best case scenario is to define State and local tax bases in law. Where cities and the State tax the same transactions, the base of tax would be the same. This is a simplification issue and pertains to a taxpayer's ability to comply.

Ms. Dickerson said, as discussed in the first meeting, one significant issue that multi-state taxpayers deal with, particularly if their tax groups are out of State, is the ability to know the differences among the cities. Commonly accepted reference material may contain the State code and maybe the city codes of Phoenix and Tucson, but would probably not include the Model City Tax Code with all the variations. ATRA does not want the cities to suffer revenue loss, but would like to provide local options for items the State does not tax, such as food, commercial lease, residential rental, etc.

- The second preference would be to place the Model City Tax Code in State law.

She stated that, again, the Model City Tax Code is not included in commonly accepted reference material. This option would allow taxpayers to have an enhanced grasp of issues in order to better comply. The intent is to eliminate surprises that out-of-state taxpayers experience.

- The third scenario is leaving the Model City Tax Code under the control of the Municipal Tax Code Commission and changing the makeup of the Commission to include State Legislators. This would broaden the view of what taxpayers and cities could bring to the Commission. If Legislators cannot serve on the Commission, an alternative option would be needed.

Ms. Dickerson related that if none of the three options are feasible, ATRA believes there must be a minimum level of change to allow the business community to comply more easily and effectively with the Model City Tax Code.

- One recommendation would be the creation of an independent hearing officer position as mentioned by the League. ATRA would like to see the independent hearing officer under the purview of the Commission, although some research would probably be necessary to see if this would create a problem.
- Secondly, ATRA would like the creation of an independent ombudsman. As the cities adopted the Taxpayer Bill of Rights, ombudsmen were set up within each city; however, ATRA believes that a single ombudsman could deal with all city problems and help the business community uncover issues in which there is a difference of interpretation or administration. If the single ombudsman reports to a centralized body, preferably the Commission, resolutions could be found to problems because a single person would be reviewing them.

- Regarding audit issues, ATRA would like elective multi-jurisdictional audits for taxpayers. The single audit would either be done at the State or city level, and the cities could audit on behalf of the State and vice versa. ATRA prefers that the State election cities eliminate outside auditors due to some conflicts. An example is a person who acts as a hearing officer for one city and an auditor for another city. It is difficult to believe the person can be unbiased in rendering hearing decisions when acting as an auditor. Therefore, ATRA would like the outside auditors eliminated or standards developed to eliminate this type of situation because taxpayers are not getting a fair hearing.
- ATRA would like to see a single point of licensing and a single return. From a compliance standpoint, having a single return with all the cities listed where taxpayers can report on one document instead of various documents would simplify the process and make it easier for taxpayers to comply. If a single return is adopted, due dates between the State and cities would have to be conformed.

Cochairman Daniels asked Ms. Connolly to review the 13 pages she provided, choose some items that are only done by one or two cities, and provide a price tag.

Mayor Scruggs expanded the request to highlighting those items that are actually reductions and not increases.

Ms. Connolly agreed to do that and provide copies to all Members.

Mayor Scruggs submitted that the recommendation of single point licensing may solve one problem, but create many others. She explained that licensing provides the ability for cities to address issues such as whether a business has the correct zoning, meets building codes, etc. If there is no licensing activity, havoc can be created in other areas; therefore, her opposition is not entirely revenue-oriented.

Cochairman Daniels asked if she is amenable to a single point in Maricopa County where a person could obtain a single license to operate, for example, five floral shops in five different cities, and a copy would be transmitted to those cities.

Mayor Scruggs said if the intent is to eliminate businesses from making multiple stops, they will still have to go to local communities for specific licenses in other areas, such as alarm licensing, Fire Department reporting, etc. She noted that the City of Glendale's license application is available on the Internet so people do not even have to travel to Maricopa County. She questioned where the central location would be and if there is an ability to have enough licensing locations, personnel, etc. Beyond that, there would also be significant impacts on the revenue side, which ATRA mentioned as something they do not want to happen.

(Tape 1, Side B)

She clarified that the League's recommendation is to have a uniform application form modeled after the State form, but administered by the cities. She understood Ms. Dickerson to say that regardless of which of the cities and towns the person resides in, a license would be obtained from the State. She submitted that not all cities allow the same types of businesses to operate in

the community, and if the businesses are allowed to operate, they are not always allowed to operate in the same kinds of districts. Therefore, the person administering the licensing process, which should be simple, would need to know whether the person is asking for a license to operate a business allowed within the specific community and if the location is zoned properly for what the person wants to do.

Mayor Scruggs related that the City of Glendale deals with massage parlors, adult movie rental places, used car dealers, and many different types of businesses. This recommendation will cause much damage to quality of life within the communities. Businesses will obtain licenses, set up shop, and then become a problem within the community, so the City would have to shut them down anyway.

Mr. McCarthy stated that the intent is not to preempt cities on oversight that goes into creating businesses. He does not believe a person can obtain a sales tax license, presume that it trumps all other zoning and regulatory issues in a city, and just begin collecting taxes. He noted that in many instances taxpayers do not know there is an independent city sales tax system, so obtaining one license from the State could actually enhance revenue for cities. He added that he is agreeable to discussing whatever problems the cities think loss of control might entail; however, he perceives the recommendation as a benefit to taxpayers and cities.

Senator Cunningham commented that a uniform application and a uniform automatic license issuance are two very distinct and different processes. He submitted that before the Committee moves forward with a recommendation for a uniform automatic license issuance, close attention should be given to implications to the cities. Very often cities do not issue licenses until there is a chance to review whether or not a business complies with various building codes, etc. Sometimes there is a delay to ascertain if a business is legitimate. He said Mayor Scruggs articulated many of the implications, but perhaps the issue could be explored further.

Cochairman Daniels expressed appreciation to everyone who brought forth recommendations. She noted that she and Senator Cunningham may have a bill and work is still in progress. She added that she will review the recommendations and test them on some of the small business people she knows in her town. She added that she does not intend to meet again, but would like to keep the option open.

Without objection, the meeting adjourned at 11:10 a.m.


Linda Taylor, Committee Secretary

(Original minutes, attachments, and tape are on file in the Office of the Chief Clerk. A copy of the minutes and attachments are on file with the Senate Secretary.)

Appendix C:
Recommendations submitted by Mayor
Scruggs on behalf of the Cities & Towns

Recommendations for Changes to Local Sales Tax System

Amend State Statute to:

1. Continue Municipal Tax Code Commission for ten years and expand its duties to listen to general taxpayer concerns.
2. Require Commission to meet quarterly on standard date (such as the third Tuesday at 10 a.m. of January, April, July, and October) with Commission to determine meeting schedule at first meeting of every year. The Commission could hold special meetings as necessary but with at least two weeks notice with Department of Revenue to maintain a list of persons interested in receiving notice of meetings.

Under the Auspices of the Municipal Tax Code Commission, Cities through the Unified Audit Committee (UAC) will do the following:

Licensing – to simplify taxpayer application and filing processes

1. The non-program cities will develop a uniform application form. (To the extent possible, the state format will be used.)
2. The non-program cities will adopt standard renewal dates for their renewal fees.
3. The non-program cities will work to develop a standard tax return form.

Auditing – to coordinate audit schedules and audit practices

4. A central reporting database will be established for all the audits performed by the cities that do their own auditing. We will work with the State to hopefully add the state information to this database.
5. All non-program city audits will be joint-city audits with the permission of the taxpayer. If the taxpayer chooses to allow a joint-city audit, then no city will do an on-site audit of that taxpayer for a period of at least one year. With cooperation from the state, this type of program could be implemented to include the Department of Revenue.
6. The cities that do their own auditing will make an annual report to the Municipal Tax Code Commission on their audit activities.

Hearings/Appeals/Interpretations – to standardize and simplify the appeals process

7. An individual request to a city for an interpretation of the tax code will be circulated among members of the UAC so that interpretations are more uniform. These interpretations will be compiled so that standard interpretations will apply in each city.
8. Initially, appeals on joint audits will have only one hearing and all of the other cities involved will abide by that ruling. The goal will be to eventually have one hearing officer for all of the cities.
9. Continue discussions with the business community on language that could be added to the Model City Tax Code regarding making new interpretations prospective only. This language would resemble the language currently in the state code.

Appendix D:
Testimony and Recommendations
submitted by Ann Dumenil,
Attorney at Law



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November 9, 1999

The Honorable Lori S. Daniels
Majority Leader
State Capitol – House Wing
1700 West Washington Street
Phoenix, Arizona 85007

Re: Testimony before Uniform Transaction Privilege Study Committee

Dear Representative Daniels:

Thank you for the opportunity to testify before the Uniform Transaction Privilege Tax Study Committee yesterday. I am enclosing a written outline of my testimony with some comments on some additional problems. Since my recommendation for a major overhaul of the state and municipal tax systems faced significant opposition, I have offered some other proposed recommendations on numerous smaller items that would benefit the business community by easing tax compliance burdens.

I would be pleased to discuss any of these suggestions in more detail with you, the members of the Committee, the League of Arizona Cities and Towns, various city taxing personnel, and the Arizona Department of Revenue.

Thank you for your interest and consideration of these matters.

Very truly yours,

JENNINGS, STROUSS & SALMON, P.L.C.

By 
Ann M. Dumenil

AMD:ae

Enclosures

**Outline of Testimony Before
Uniform Transaction Privilege Tax Study Committee
November 8, 1999**

By Ann M. Dumenil*

I testified before the Legislative Study Committee on Municipal Taxation back in the mid-1980's on the problems encountered by businesses in having to comply with separate transaction privilege ("sales") and use tax codes for the state and Arizona's various cities and towns, and on the unreasonable administrative burdens that the multiple tax codes caused. Ironically, my comments today will parallel many of the earlier comments because many of the problems still exist.

Legislative Study Committee in the mid-1980's had Two Recommendations:

- Reduce the differences between state and city tax sales tax codes; and
- Reduce the differences among the various cities sales tax codes

The Model City Tax Code did not reduce the differences between state and city sales taxation; instead, it magnified the differences.

- Prior to the cities' adoption of the model code in 1987, the vast majority of the city sales tax codes employed the same language as the state sales tax code.
- Prior to the model code, cities generally followed the state tax treatment. Absent a city regulation to the contrary, the cities routinely applied the state tax rules, regulations, case law and interpretations in construing their local tax.
- When the city taxing officials wrote the model city tax code, they ignored the language in the state tax law; instead they created an entirely new tax code that:
 - used entirely different language to describe the taxable activity
 - different definitions
 - in many instances, they expanded the tax base
 - they shrunk the number and availability of tax exemptions
 - they increased the administrative documentation requirements and increased the compliance burden on business
 - The model code was written to circumvent many court cases that had been favorable to taxpayers -- *Dermis; Duval Sierrita; Shamrock Foods; Swift*
- Rather than try to eliminate differences between state and municipal taxation, as charged by the Legislative Study Committee, the cities wrote a model city tax code that created substantially greater differences between state and municipal taxation.
- **Recommendation:** Require cities to meet with the business community to re-examine the multiple differences between state and municipal sales and use taxes and to eliminate unnecessary differences between state and local taxation.

* Ann M. Dumenil is an attorney with the Phoenix law firm of Jennings, Strouss & Salmon, P.L.C. She is certified as a Tax Specialist by the State Bar of Arizona. She has practiced for more than 18 years in the area of Arizona state and local taxation. She has represented taxpayers in most of the business tax classifications before the state and many of the cities that administer their own taxes. She has litigated numerous tax cases. She has also been a frequent seminar speaker on Arizona state and local transaction privilege and use tax issues.

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Privilege Tax Study Committee
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The Model Code also has not eliminated differences among the various cities and towns.

- When they created the model city tax code, the cities retained the vast majority of the local differences from the prior city tax codes
 - 16 model options
 - 36 local options
 - numerous more "green page" differences
- There are a few key differences, such as food sales by grocery stores, that generate significant revenues; but the vast majority of these differences are minor in tax revenues: e.g., coin operated car washes, whether one or two units of residential rentals exempt
- Result is 1 state sales tax code + 87 different city sales tax codes
- **Recommendation:** Have the cities review these differences and eliminate those that have minor revenue impacts; reduce the number of variations among the cities

Businesses that operate in more than one Arizona city or town have problems trying to comply with the state tax code and the 87 different city tax codes

- Time-consuming and costly for a business to have to learn about all the differences between the state tax code and the tax codes of the various cities where it engages in business; not a reasonable administrative burden on business
- No uniform or consistent interpretation among cities. While the Department of Revenue is generally consistent on the interpretations for the cities in the state collection program, each of the cities that self-collect can have their own interpretation of the tax code.
 - same exact city tax code language can be interpreted differently by different cities
 - Numerous "hidden" differences because of different interpretations
 - Tough luck for any business that relies on one city's interpretation
 - **Recommendation:** If a business can show that it reasonably followed the interpretation of one city or town, then another city should not apply a different interpretation retroactively in an audit context.
- **Multiple Licensing & Filing Requirements -- Multiple Tax Returns each month -- costly & time-consuming for business**
 - **Recommendations:**
 - Consider a single licensing form that can be used by the Department and the various cities -- so a business can file in one location for the various tax licenses;
 - Develop a joint monthly tax return form for the state and all cities that can be filed to one location
- **Other Problem Areas: Different record-keeping requirements; different exemption claim forms**
 - The cities have adopted some unnecessary and costly record-keeping requirements.
 - **Recommendation:** Review the cities' extensive requirements and eliminate the unnecessary, additional city record-keeping requirements.

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- The Department of Revenue has developed forms for claiming tax exemptions. Since the early 1990's, businesses have repeatedly requested that the Department and the cities adopt a single form that can be used for claiming sales and use tax exemptions for both state and city tax purposes.
- **Recommendation:** Require the development of a joint tax exemption form; or in the absence of a joint form for claiming tax exemptions, require the cities to allow a business to use the Department's tax exemption form to establish exemption claims for both state and city sales and use tax purposes.
- **Major Problem Area -- Model Code has various jurisdictional tests to establish which Arizona city or town can claim the right to tax a sale. Factors include:**
 - where title and possession transfer
 - where the buyer places the order
 - where the seller receives the order
 - where the warehouse or storage facility is located
 - where the sales office is located
 - where the construction site is located
 - where the service activity is performed
 - where the property is stored or used
- **Example:** seller's retail sales office in City 1; buyer located in City 2; seller's warehouse in City 3; delivered to buyer's site in City 4
 - now compound the problems: some cities exempt the sale -- others tax the sale;
 - plus the cities all have different city tax rates
- Numerous city audits where more than one city wants to tax the same transaction; or the same city is simultaneously going after both the seller and the buyer for the tax on the same sale
- Businesses repeatedly sought help from the Arizona Legislature to resolve multi-jurisdictional tax problems -- see A.R.S. § 42-6003 (former A.R.S. § 42-1452)
 - They first sought protection from double taxation. State law first required cities to give full credit if the city sales tax has been paid to one appropriate city or town. A.R.S. § 42-6003
 - suppose to take the taxpayer out of the dispute
 - lets the cities fight over the city sales taxes
 - Subsequent amendments to A.R.S. § 42-6003 attempted to resolve the problems arising when some cities tax the sale and some cities exempt the sale; also tax rate differential problems
 - If the sale is exempt under the code of an appropriate city or town, another city can't tax that sale retroactively
 - If the tax is paid at one rate to an appropriate city or town, another city with a higher tax rate can't impose an additional tax on the same transaction retroactively
 - Despite the state law protections, there still are problems with cities failing to follow the state law.

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- **Recommendations:**
 - Review A.R.S. § 42-6003 and add additional protections to resolve these and other multi-jurisdictional audit problems that businesses encounter
 - Perhaps have some Taxpayer Assistance Office where taxpayers can bring complaints where a city fails to follow A.R.S. § 42-6003
- **Problems with Retroactive Application of New Interpretations**
 - Rule-making versus audit functions
 - Rule-making requires notice to businesses of any proposed new interpretation, an opportunity for taxpayers to comment on the proposed new interpretation, and prospective application only of the new interpretation. Prospective application allows taxpayers to collect the taxes from customers, adjust their prices to factor in the taxes, or take other appropriate steps to address tax liability (such as separating charges for the taxable activities from non-taxable activities).
 - Audits can only be used to assess back taxes where there has been a clear rule of law; the audit cannot be used to test new theories or new interpretations.
 - These principles stem from constitutional due process rights that require clear notice of what activity is subject to taxation.
 - There is a new state law enacted in 1998 that follows these principles: If the Department adopts a new interpretation that increases the tax base, the Department can apply the new interpretation **prospectively only**. See A.R.S. § 42-5039.
 - This new state law follows the constitutional due process principles that there must be clear notice of what activity is taxable and the law regarding rule-making versus audit authority.
 - Cities frequently refuse to grant a taxpayer the constitutional due process protections or to recognize the distinction between the city's rule-making vs. audit authority.
 - City can invent some new interpretation and hit unsuspecting businesses with audit assessments for back taxes, penalties and interest based on this newly adopted interpretation
 - **Recommendation:** Legislative relief is needed to limit this abusive practice by cities. Enact a provision comparable to A.R.S. § 42-5039 that requires cities to apply new interpretations **prospectively only**.
- **Problems with Multiple Audits – from the state and each of the cities**
 - Multiple audits are time consuming & costly to business
 - Joint Audits – currently decided by State and cities without taxpayer input; allow taxpayer election
 - Problem that no single forum for appealing multiple city audits. The business has to file tax appeals to the hearing officer in each city in the joint audit resulting in multiple hearings, multiple briefs, etc. It is very expensive for business to have multiple litigation costs to fight the audit assessments in multiple forums.

Testimony Before Uniform Transaction
Privilege Tax Study Committee
November 8, 1999
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- Costly for the Department and each city to have separate tax administrators, separate auditors, separate hearing officers, etc. Duplicative government costs waste taxpayer money.
- **Recommendation:** Consolidate the audit and appeal functions. Have the Arizona Department of Revenue perform all audit functions and have the Department and/or Administrative Hearing Office serve as the hearing office for all state and city sales and use tax appeals.
- **Problems with Inconsistent Hearing Officer Rulings – No Uniform Interpretations.**
 - **Recommendation:** This problem can be eliminated if there is a uniform appeal procedure for both state and city sales and use tax issues.

Closing Comments: In 47 states, there is one tax code, one set of regulations or rules, and one set of interpretations for complying with the state and local sales and use tax requirements. In those states, there is one system for administering the tax laws, including licensing, record-keeping requirements, filing returns, auditing and protesting audit assessments. In some of those states, each of the cities can also decide what its city tax rate will be for the various taxable activities that are set forth in the state code.

Arizona's system with 88 different tax codes for state and municipal sales and use tax purposes, the multiple variations of exemptions and interpretations, the multiple licensing requirements, multiple record-keeping requirements, multiple filing requirements, multiple audits and multiple appeal forums and procedures results in an overly complex system that is

- Poor Tax Policy
- Very Costly for Business Compliance
- An Unnecessary Multiplying of Costs so that cities can each administer their own tax system – multiple sets of auditors, multiple administrators, multiple licensing personnel, etc. – a waste of tax resources
- An Antiquated System that doesn't make sense as businesses move into the global economy of the 21st Century

Recommendation: The system is still broken; it needs to be fixed. The Committee should consider creating one statewide uniform system of tax laws, regulations and interpretations and one uniform system for administering and enforcing Arizona's state and municipal transaction privilege and use taxes. The cities should be able to set their own tax rates for the various tax classifications in the uniform state system.

Absent major restructuring, there are numerous areas where the cities could work with the business community in trying to eliminate unnecessary differences between state and city tax law and unnecessary differences among the various cities. The state and cities should also take additional steps to simplify the administration and enforcement of the state and city tax laws.

Appendix E:
League of Arizona Cities & Towns
Comparison of the State and Model City
Tax Codes



THE LEAGUE OF ARIZONA CITIES & TOWNS

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October 15, 1999

The Honorable Lori S. Daniels
Majority Leader
State Capitol - House Wing
Phoenix, Arizona 85007

Dear Representative Daniels:

This letter and the accompanying documents are in response to your September 29, 1999 letter requesting information on four issues relating to the Model City Tax Code Study Committee. As you know, local sales tax authority is very important to all the cities and towns of Arizona; it is the principal source of local revenue for nearly every city and town in the State. We look forward to sharing with the Committee the benefits of this system and our belief that the current system should be maintained.

Your letter requested the following:

1. A comprehensive comparison of the differences and similarities of the State transaction privilege tax statutes and the Model City Tax Code. This comparison is attached.
2. Examples of major differences between city ordinances and the model city tax code. A listing is enclosed of variations; there really are no "major" differences.
3. The League's opinion on how the unified audit committee is working. This response appears below.
4. The League's current position on the taxation of e-commerce transactions. At our recently completed Annual Conference, the cities and towns adopted a resolution on this subject which is attached. The League has been participating in the legislative interim committee meetings on this subject, monitoring the activities of the federal commission meeting on this subject and working with cities, particularly in the West, on a national response.

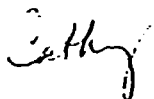
The Unified Audit Committee consists of tax administrators from twelve cities which collect their own sales tax, representatives from six cities and towns which participate in the state collection program but also do supplemental local auditing, the Department of Revenue and the League. The Committee's main function is to promote uniform application of the model city tax code through discussion of tax provisions and their application and interpretation. The Committee also works on audit coordination and performs joint audit selection on an annual basis whereby one city audits for itself and other jurisdictions at the same time. This audit selection process seeks to avoid multiple audits of a single taxpayer.

The Committee meets every other month and has resolved many of the issues which arise with enforcement of the same laws by multiple jurisdictions. The Committee also performs the review of suggested changes to the code by both cities and towns and the business community, and a subcommittee works with the League in meeting with the business community on their proposed changes.

The Committee takes its responsibility seriously and works hard to achieve the goal of consistent and fair application of the model city tax code. It provides essential coordination among the cities in the interest of all cities and towns as well as the business community.

I hope this letter and the attached documents provide the information you wanted for your deliberations. If we can provide additional information, please let me know.

Sincerely,



Catherine F. Connolly
Executive Director

cc: Melodie Jones

Differences Between the Model City Tax Code and the State Tax Code

Introduction

The Model City Tax Code originated in response to one of the recommendations of a legislatively established committee called the Municipal Sales Tax Study Commission. The Commission issued its recommendations in late 1984; a year was spent in preparation of the code with another year of negotiations with the business community on provisions. The final code was issued in late 1986 and became effective in nearly all the cities and towns in 1987. All cities and towns operate under the Model Code today. The cities and towns developed the code under the auspices of the League of Arizona Cities and Towns using the City of Phoenix tax code as the base. The Phoenix code was chosen because its provisions were the most familiar to the largest number of taxpayers among the various city tax ordinances then in existence.

The code replaced the individual transaction privilege tax ordinances then in effect in each city and town with a local tax. The League maintains a master version of the model city tax code which consists of an extensive index, text pages, an explanation of each option available under the code, the options chosen by each city and town and an individual page (called green pages) for each city and town listing tax rates, a contact number, whether the city or town is in state collection or self-collection and other related information. This code allows a multi-jurisdictional taxpayer to have one document instead of a shelf full of individual ordinances to determine their tax liability. A one-location or one city business may choose instead to simply consult that city's tax code.

In the following document we have listed the differences between the state transaction privilege tax statutes (State Code) and the model city tax code (Model Code). Many of these differences resulted from tax exemptions granted by the Legislature since the Model Code was adopted. The League was assisted in the preparation of this document by representatives of the Cities of Mesa, Phoenix, Scottsdale and Tempe. This was prepared as a policy document for purposes of discussion by the interim committee; it should not be considered a technical tax analysis. Some of the differences are general while others are specific as they relate to various options within the code. We have attempted to make the comparison as comprehensive as possible.

Administration - The provisions are substantially similar.

- The Model Code requires management approval to assess penalties; the State Code does not.
- The Model Code includes all of the regulations. The regulations for the State Code are a separate document.
- The Model Code allows cities/towns the option of placing a moratorium on taxes following annexation for construction activities and rental of real property for commercial purposes by choosing Local Option C. Three cities/towns have chosen that option. The State Code has no similar provision.

- The State Code and Model Code due dates are the same, but the Model Code provides that taxes are not delinquent until the start of the first full month after they are due, which is later than the State Code.
- In the comparison of gross receipts in the State Code and gross income in the Model Code, the Model Code specifically includes barter, exchange, reduction of or forgiveness of indebtedness and the State Code does not.
- The State Code allows an accounting allowance. The Model Code does not provide for an such an allowance.
- The State Code's reporting thresholds for quarterly and annual filers are:
 Quarterly \$500-1,250 in tax; Annually \$500 or less in tax
 The similar Model Code's reporting thresholds are:
 Quarterly \$5,000 – 50,000 in taxable activity; Annually Less than \$5,000 in taxable activity
- State Code allows consolidated filing. The Model Code does not.
- Model Code section 595 imposes a tax on taxpayers that foreclose or acquire recently improved real property through a trustee sale and subsequently resell the property. The State Code does not have a similar provision.
- Proprietary clubs have greater exemptions under the State Code. The Model Code taxes certain clubs if income from non-club related activities exceeds 15%.

Definitions

- The Model Code has placed all definitions in the same section, while the State Code has put them throughout the code within each classification.
- The Model Code's definition of Casual excludes sales and leases of real property. This difference means that the State Code would consider the sale of an entire business operation to be casual.
- The Model Code defines broker and provides examples of when a broker is subject to the tax. The State Code is not as detailed.
- The definition of person in the State Code does not include broker or the Federal Government. Further the Model Code's definition states that a person shall be considered a distinct and separate person from any general or limited partnership or joint venture or other association with which such person is affiliated. A subsidiary corporation shall be considered a separate person from its parent corporation for purposes of taxation of transactions with its parent corporation. The State Code does not specify this.
- A.R.S. § 42-5013 addresses partnerships and how tax liability will be determined. The Model Code does not address this.

Advertising

- The State Code does not tax this category. The Model Code uses the old State Code language. The cities/towns can elect not to tax this category by selecting Local Option G. Ten cities/towns have selected that option and two other cities/towns apply a 0% rate to the class.

Amusements

- The State Code specifically exempts: events by the Arizona Coliseum and exposition board and the county fair commission. It also exempts musical, dramatic or dance groups or a botanical garden, museum or zoo that qualify as a 501(c)(3) nonprofit. The Model Code exempts this classification also unless Local Option H is chosen. This option taxes health spas, fitness centers, dance studios and rental of premises for sports, athletic or other health-related activities or instruction per-event or long-term including membership fees. Thirty-one cities and towns have chosen Local Option H.
- The State Code exempts private or group instructional activities and activities/projects of bona fide religious or educational institutions. No specific exemption exists but the Model Code exempts all events done by qualified 501(c)(3) organizations.
- The State Code exempts membership to health/fitness establishments. The cities also exempt this unless Local Option H is selected, and 31 cities and towns have chosen this option.
- The State Code exempts membership fees that provide for the right to use a transient lodging recreation establishment or private recreational establishment which includes golf, tennis and racquet courts for 28 days or more. The Model Code does not specifically exempt this activity.
- The State Code exempts wagering activities except under A.R.S. § 5-111. The Model Code does not exempt this activity.

Contracting

- The State Code treats the installation of window coverings (drapes, mini-blinds, etc.) as contracting. The Model Code treats it as retail with the installation charge as retail service labor.
- The State Code provides an exemption for construction in a military reuse zone. The Model Code provides no exemption except under Local Option D. No cities/towns currently use this option.
- The State Code has a bonding requirement for the payment of taxes for out-of-state contractors doing business in the state for less than one year. The Model Code has no similar requirement.
- The State Code taxes subcontractors installing offsite infrastructure. The cities/towns tax this as a sale of offsite improved real property.
- The State Code provides a deduction of up to \$5,000 for solar energy devices. The Model Code does not provide such an exemption.

- The State Code allows a land deduction from prime contracting for fair market value of improved land. The Model Code provides a deduction for land under Local Option M or N. Six municipalities have chosen Local Option M, and 21 have selected Local Option N.
- The State Code exempts contracting income from constructing a qualified environmental technology manufacturing, producing or processing facility that produces solar and other reusable energy products. The Model Code provides no similar exemption.
- The Model Code defines "independent functional utility" and when replacement of an item is retail or contracting activity. The State Code makes no distinction.
- The State Code imposes a tax upon owner-builders who within 24 months after improvements are complete, installs additional improvements upon property. The basis of this tax is the value added by the additional improvements. The Model Code has provisions to address this situation under speculative builder.

Feed at Wholesale

- The State repealed the feed classification in 1994. The Model Code exempts feed but also has an option (Local Option P) to tax feed which 19 cities/towns have chosen.

Hotel & Transient Occupancy

- Most cities have both a hotel tax and a transient occupancy tax, while the state has a single transient lodging category. Forty-eight municipalities use the option for a transient occupancy tax by choosing Model Option 6.
- The State Code exempts bed and breakfasts consisting of fewer than 4 units; the Model Code does not.
- The State Code exempts mobile home and house trailers, while the Model Code does not.

Jet Fuel Sales

- The State Code taxes jet fuel sales. The Model Code does not tax jet fuel unless Local Option LL is selected. Ten municipalities have selected Local Option LL; the remaining jurisdictions do not have jet fuel sales within their boundaries.
- The State Code taxes only the first ten million gallons of jet fuel sold. It also exempts sales to commercial airlines when used on flights which originate in this state and whose first outbound destination is outside of the United States. Under Local Option LL, the Model Code taxes all sales/purchases of jet fuel.

Job Printing

- The State Code has a deduction for job printing for items distributed without consideration in connection with the publication of a newspaper or magazine. The Model Code has an exemption for job printing of newspapers, periodicals, publications, for a person who is subject to this tax or an equivalent excise tax if they are properly licensed under the publishing classification. Model Option 3 imposes the tax on job printing for publishers that distribute the publication without charge. Sixty municipalities have chosen this option.
- The State Code allows an exemption for use outside the state if the vendor ships or delivers the material outside the state regardless of where title passes. The Model Code has an exemption, but the transaction must meet the requirements under the definition of out-of-state sales unless Local Option MM, which mirrors the state language, is selected. One city has selected that option.
- The State Code does not include printing plates, micrographics and photo reproduction under the activity of job printing. The Model Code does.

Manufactured Buildings

- The State Code taxes this activity under its prime contracting classification. The Model Code taxes the sale of new manufactured buildings at the dealer location, and sales of used manufactured buildings are not taxable. The Model Code provisions were implemented at the request of the manufactured housing industry.

Membership Camping

- Certain membership fees to Arizona residents are exempted under the State Code; there is no similar provision in the Model Code.

Mining

- The State Code's mining classification is non-metalliferous mining. Metalliferous mining is covered under the severance tax. Under the Model Code, both types of mining are under mining and the State has imposed a maximum rate on the municipalities of 0.1% on this classification.
- The State Code taxes sand and gravel operations under mining, while the Model Code taxes such operations under the retail classification.

Motion Picture Production

- The State Code allows a refund of taxes paid if one or more motion pictures are made in Arizona in a 12 month period. The Model Code has no similar provision.

Publishing

- The State Code has deducted advertising from the tax base, but the Model Code taxes local advertising under the publishing classification. This classification includes definitions for Location of Publication, Subscription Income, Circulation and Allocation of Taxes Between Cities/Towns.

- The State Code exempts the sales of magazines, periodicals or other publications by this state to encourage tourist travel. The Model Code does not exempt these publications.
- The State Code allocates tax to the county where the newspaper, magazine or other periodical or publication is published. The Model Code allocates gross income from publication based on circulation where distribution occurs in more than one city or town.

Rental Occupancy pre-December 1, 1967 Leases

- The State Code does not tax residential rental occupancy but it did tax commercial. The Model Code does not impose a rental occupancy tax, but there is a local option (Local Option Q) which does impose the tax on both residential and commercial leases. Twenty-seven cities/towns have selected this option.

Rental of Real Property

- The Model Code taxes rental, leasing or licensing for use of commercial and residential property located within the city/town limits, although there are options to exempt this activity also included in the Model Code. The State does not tax this activity.
- The State Code does not tax licensing for use. The Model Code taxes licensing agreements.
- The State Code taxes the lessor of the property. The Model Code taxes the person leasing or licensing to the tenant in possession.
- Other exemptions in the State Code not allowed by the Model Code:
 - Activities engaged in by the Arizona exposition and state fair board or county fair commissions.
 - Leasing real property for boarding horses.
 - Leasing or renting real property for a rodeo featuring primarily farm and ranch animals sponsored, operated or conducted by a nonprofit organization that is exempt from taxation under section 501(c)(3), 501(c)(4), 501(c)(6), 501(c)(7) or 501(c)(8).
 - Leasing or renting real property and improvements for use primarily for religious worship by a nonprofit organization that is exempt from taxation under section 501(c)(3).
 - Leasing or renting real property used for agricultural purposes under either of the following circumstances:
 - The lease or rental is between family members, trusts, estates, corporations, partnerships, joint ventures or similar entities, or any combination thereof, if the individuals or at least eighty per cent of the beneficiaries share a family relationship.
 - The lessor leases or rents real property used for agricultural purposes under no more than three leases or rental agreements.
 - Leasing, renting or granting the right to use real property to vendors or exhibitors or industry association which is a qualifying organization pursuant to section 513(d)(3)(C) for a period not to exceed twenty-one days in connection with an event.
 - Leasing or renting a transportation facility.

- The State Code exempts rentals between affiliated corporations if 80% ownership exists. The Model Code taxes affiliated corporations unless Local Option T is selected. Four cities have selected this option.
- The State Code and the Model Code consider lessors of one unit of commercial property to be engaged in business and subject to tax, unless a city/town chooses Local Option R. Six cities/towns have chosen this Option.
- Both the State Code and the Model Code exempt rentals to non-profit primary health care facilities, unless a city/town chooses Model Option 4 which allows the tax. Thirty-nine municipalities have selected that option.
- The State Code has an exemption for leases of real property to a proprietary licensed nursing care facility. The Model Code does not include this exemption.

Rental of Tangible Personal Property

- The State Code does not tax licensing for use.
- The State Code taxes leases at the site of the lessor. The Model Code taxes long term leases (180 days or more) based on the location of the lessee. The Model Code taxes long term vehicle leases (24 months or more) based on the location of the dealership.
- Other exemptions to the State Code that are not allowed by the Model Code:
 - Activities engaged in by the Arizona exposition and state fair board or county fair commissions.
 - The leasing or renting of tangible personal property by a parent corporation to a subsidiary corporation or by a subsidiary corporation to another subsidiary of the same parent corporation if taxes were paid from the initial sale of the tangible personal property.
 - The leasing or renting of semi-trailers manufactured in Arizona.
 - The leasing or renting of tangible personal property for incorporation into or comprising any part of a qualified environmental technology facility.
 - The leasing or renting of aircraft, flight simulators or similar training equipment to students or staff by nonprofit, accredited educational institutions.
 - The amount received from leasing of solar energy devices.
 - The leasing of new alternative fuel vehicles and equipment that is installed in a conventional motor vehicle to convert the vehicle to operate on an alternative fuel.
- The Model Code and the State Code exempt coin operated laundries unless a city/town selects Model Option 7 to tax them. Fifty-six have selected that option.

Restaurants and Bars

- The State Code gives deductions to sales by congressionally chartered veterans organizations, churches, fraternal benefit societies and other non-profits. The Model Code does not have specific language for all of these organizations, but they give a similar deduction to 501(c) non-profits which would cover most of these same organizations.
- The State Code has an exemption for sales of prepared food to be consumed in a prison or similar facility. The Model Code does not have a similar provision.

Retail

- Motion picture production companies and commercial advertisers are allowed a refund under the State Code if they produce one or more motion pictures or commercial advertisements in the State. No similar refund exists in the Model Code.
- Primary nexus for the right to the tax due from a transaction is different. A.R.S. § 42-5034 states that for retail sales it shall be the county where the sale is made. Where the sale is made may be considered to be the customer location and not the permanent business location of the seller under the Model Code.
- The State Code exempts sales by non-profit charities and does not have the exceptions to that exemption that the Model Code does. Unrelated business income is taxable under the Model Code and also the sales made by 501(c)(7), (8) and (9) organizations when their sales to persons other than members and bona fide guests of members are in excess of 15% of total gross revenue.
- The out-of-state sales exemption is different for retail sales in that although the purchase is delivered by the seller to the purchaser outside the state the city/town requires that the order be placed from outside the state in order for the sale to be exempt, except for the sale of motor vehicles. The sale of motor vehicles differs in that the State Code allows the purchaser to take possession of the vehicle and drive it out of the State if the purchaser's State of residence imposes a tax and does not allow for reciprocity and the non-resident obtains a 30 day non-resident registration. The Model Code requires delivery of vehicle to take place out-of-state.
- The State Code exempts sales of food for home consumption. The Model Code exempts food for home consumption but also includes a Model Option 2 for cities and towns to tax food. Sixty-seven cities and towns have chosen this option.
- The State Code exempts the sale by a bookstore of textbooks required by a state university or community college. The Model Code taxes such sales, but an exemption is allowed under Local Option Z and three municipalities have chosen this option.
- The State Code exempts sales of tangible personal property to 501(c)(3) organizations that regularly provide meals to the needy at no cost. The Model Code's exemption is for food, beverage, condiment and accessories that facilitate the consumption of food, not all tangible personal property purchased.

- Magazines and other publications by the State to encourage tourist travel are exempt from the State Code. The Model Code does not exempt these items.
- The State Code exempts sales of motor vehicles to enrolled members of Indian tribes that reside on reservations established for that tribe. The Model Code exempts any retail sales to Native Americans or tribal councils provided the order is solicited and placed from the reservation, delivery is made to the reservation, and the payment originates from the reservation.
- The State Code exempts machinery, equipment, technology or related supplies that are only useful to assist a person who is physically disabled as defined in A.R.S. § 46-191, has a developmental disability as defined in A.R.S. § 36-551 or has a head injury as defined in A.R.S. § 41-3201, to be more independent and functional. The Model Code would exempt these items to the extent they qualify under the exemption for prosthetics.
- The State Code exempts coal, petroleum, coke, natural gas, virgin fuel oil and electricity sold to an environmental technology manufacturer, producer or processor. The Model Code does not have a similar exemption.
- The State Code exempts sales of implants used as growth promotants and injectable medicines, not otherwise exempt, for livestock or poultry owned by or in possession of persons who are engaged in producing livestock, poultry, or livestock or poultry products or who are engaged in feeding livestock or poultry commercially. These items may fall under vitamins or items prescribed or recommended by a veterinarian, livestock or plants for farming and to that extent are exempt under the Model Code.
- The State Code exempts equipment that is installed in a conventional motor vehicle to convert the vehicle to operate on an alternative fuel, as defined in A.R.S. § 43-1026. No similar exemption exists under the Model Code.
- The State Code exempts the sale of neat animals, horses, asses, sheep, ratites, swine or goats used or to be used as breeding or production stock, including sales of breeding or ownership shares in such animals used for breeding or production. Under the Model Code all of these areas are exempt, unless Model Option 10 is chosen, except for neat animals and to exempt them Local Option W must be chosen. Sixty-three municipalities have chosen Model Option 10 and 9 have selected Local Option W.
- The State Code exempts new machinery and equipment consisting of tractors, tractor-drawn implements, self-powered implements, machinery and equipment that are necessary for extracting milk, and for cooling milk and livestock, and drip irrigation lines used for commercial production of agricultural, horticultural, viticultural and floricultural crops and products in this state. The Model Code offers the option to exempt these materials under Local Option A. Nine municipalities have chosen this option.
- The State Code exempts machinery and equipment sold to a person engaged in the commercial production of livestock, livestock products or agricultural, horticultural, viticultural or floricultural crops or products in this state and that is used directly and primarily to prevent, monitor, control or reduce air, water or land pollution. The Model Code does not provide this exemption.

- The State Code exempts sales of machinery, equipment, materials and other tangible personal property used directly and predominantly to construct a qualified environmental technology manufacturing, producing or processing facility. The Model Code does not provide this exemption.
- The State Code exempts overhead materials or other tangible personal property that is used in performing a contract between the United States government and a manufacturer, modifier, assembler or repairer. This includes property used in performing a subcontract with a government contractor who is a manufacturer, modifier, assembler or repairer, to which title passes to the government under the terms of the contract or subcontract. Also included are sales of overhead materials or other tangible personal property to a manufacturer, modifier, assembler or repairer if the gross proceeds of sales or gross income derived from the property by the manufacturer, modifier, assembler or repairer will be exempt. The Model Code does not provide this exemption.
- The State Code allows a deduction from the tax base for the amount received from sales of solar energy devices, but the deduction shall not exceed five thousand dollars for each solar energy device. The Model Code does not provide this exemption.
- The State Code considers the total amount of gross income, gross receipts or gross proceeds of sales for nuclear fuel to be the value of the purchase price of uranium oxide used in producing the fuel. The Model Code does not provide this exemption.
- No determination for out-of-city sales exists in the State Code.
- The State Code allows a retailer who is a street or sidewalk vendor and who uses a pushcart, mobile facility, motor vehicle or other such conveyance to sell food for home consumption which is exempt. The Model Code does not specifically state this for cities which exempt food for home consumption. The Model Code states that they are considered restaurants when selling in public areas or at entertainment or sports or similar events.
- The State Code exempts food sales to a regularly organized private or parochial school. The Model Code does not provide this exemption.
- The State Code exempts food sales to a licensed child care facility. The Model Code does not provide this exemption.
- The Model Code exempts fertilizer, fungicides, seed treating chemicals and other similar chemicals purchased by persons continuing in the business of farming, ranching, or feeding livestock, poultry or ratites unless Model Option 10 is chosen. Sixty-three municipalities have chosen this option.
- The State Code exempts the sale of semi-trailers manufactured in Arizona. The Model Code does not provide this exemption.
- The State Code exempts all employee meals in a restaurant. The Model Code under Local Option AA provides the same exemption. Eighteen municipalities have chosen this option.

- The Model Code provides the ability with Local Option V to tax big-ticket purchases at a lower rate. Eighteen cities/towns have chosen this option. No similar provision is in the State Code.
- The State Code exempts sales of food or drink and accessories to a public school district. The Model Code exemption includes these items and more.
- The State Code exempts sales by a non-profit rodeo. The Model Code has no specific exemption, but all events by qualified 501(c)(3) organizations are exempt.
- The State Code exempts the sale of paper machine clothing to a paper manufacturer, while the Model Code provides no such specific exemption.
- The State Code exempts sales by a personal property liquidator. The Model Code gives no similar exemption.

Severance/Timbering and other Extraction

- Under the State Code, timbering and other extraction is classified under severance tax. Under the Model Code, it is included under Timbering and other Extraction.
- The State Code places a limit of \$2.13 per 1000 board-feet for Ponderosa Pine and \$1.51 per 1000 board-feet for all other species. The Model Code does not have this limitation.

Telecommunications

- The Model Code taxes alarm monitoring, cable television (28 cities do not tax under Local Option DD) and access fees to a telecommunication network. Franchise fees are offset against tax under the Model Code, but there is a Model Option which deletes this offset.
- The State Code is silent on nexus for mobile telecommunications services, which is specified in the Model Code.
- The State Code specifically taxes directory publishing under telecommunications; the Model Code does not.

Transporting for Hire

- Much of this area of taxation has been preempted in favor of the motor carrier tax. If not subject to taxation under those provisions, the tax on transporting for hire can be imposed.
- The State Code exempt towing operations. The Model Code taxes them unless Model Option 12 or Local Option FF are selected. Eleven have selected Model Option 12 and one has selected Local Option FF.
- The State Code and the Model Code tax the transporting of persons/property to a point outside the city unless Local Option EE is selected to exempt this activity. One city has chosen this option.

- The State Code provides an exemption for a railroad pursuant to a contract with another railroad when the other railroad is subject to the tax. The Model Code does not provide this specific exemption.

Use Tax

- The State Code imposes a use tax. The Model Code offers this as Model Option 15. Fifty-five municipalities have chosen this option.

Note: The differences between the Model Code and the State Code are primarily the same as under the retail classification with the following exceptions:

- The State Code specifically includes purchases from a utility business under its levy of use tax. The Model Code does not specifically include utilities under use tax.
- The State Code exempts purchases of up to \$200 per person per month made by an individual at retail outside the continental limits of the United States for the individuals own personal use and enjoyment. The Model Code does not give such an exemption.
- The State Code exempts purchases made by a nonprofit charitable organization qualified under section 501(c)(3) if the property is purchased from the parent or an affiliated organization that is located outside of Arizona. The Model Code provides no such exemption.
- The State Code exempts the removal of vehicles from inventory of a motor vehicle dealer and provided to charitable or educational institutions exempt under section 501(c)(3), public educational institutions and State universities or affiliated organizations of a State university. Under Local Option HH, the Model Code allows an exemption for any tangible personal property purchased by a business subject to taxation where the item was bought in the ordinary course of business for resale to be donated to any 501(c)(3) organization, but does not extend these provisions to donations to State universities or affiliated organizations of a State university.
- The State Code exempts tangible personal property that is or directly becomes an ingredient or component part of cards used as prescription plan identification cards. The Model Code has no such exemption.
- The Model Code exempts tangible personal property that does not exceed one thousand dollars per item that is acquired by an individual outside the city/town limits for his personal use and enjoyment. The state has no similar exemption.
- The State Code requires retailers making substantial and recurring sales into Arizona to collect and remit use tax. The Model Code makes no such requirement.

Utilities

- The Model Code offers a tax credit offset for franchise fees paid unless Model Option 13 is selected. Forty-six municipalities have chosen this option. The State Code has no similar provision.
- Cities/towns may tax utility users that are not within the city/town limits unless they are within the boundaries of another municipality by choosing Local Option GG. Forty-two have chosen this option. There is no similar provision in the State Code.
- The State Code exempts utility sales to an environmental technology manufacturer, producer or processor. The Model Code does not have this exemption.
- 1998 legislation changed the electric utility language to allow for a use tax on out-of-state suppliers. No similar amendment has been made to the Model Code. The cities/towns are working with industry on appropriate changes to the Model Code.

Prepared by: League of Arizona Cities and Towns
October 1999

City/Town Variations from the Model City Tax Code

Avondale	▶ Uses a different licensing structure
Casa Grande	▶ Exempts from taxation sales of job printing shipped or delivered out-of-state
Chandler	▶ Uses a different licensing structure; chemicals used in manufacturing are taxed
Chino Valley	▶ Imposes an additional tax on pipeline operations
Eagar	▶ Exempts from taxation logging
Flagstaff	▶ Exempts from taxation logging ▶ Exempts from taxation transporting persons or property by railroad
Glendale	▶ Uses a different licensing structure ▶ Exempts from taxation owners of four or less real property rental units ▶ Exempts from taxation dance studios
Mesa	▶ Uses a different licensing structure
Nogales	▶ Exempts from taxation non-retail sales to purchasers from foreign countries
Peoria	▶ Uses a different licensing structure
Phoenix	▶ Uses a different licensing structure ▶ Makes additional requirements on the advertising tax ▶ Imposes an additional tax on nonresidential leases & short-term motor vehicle rentals ▶ Grants a special tax credit offset for cable licenses ▶ Imposes a tax on wastewater removal services
Prescott Valley	▶ Imposes a tax on wastewater collection and treatment
Scottsdale	▶ Uses a different licensing structure ▶ Imposes a tax on wastewater removal services
Surprise	▶ Sets a lower rate on food sales
Tempe	▶ Uses a different licensing structure ▶ Exempts from taxation dance studios
Tucson	▶ Adds a definition of "combined taxes" ▶ Excludes certain activities occurring on Davis Monthan Air Force Base ▶ Phased out special tax on advertising ▶ Imposes a public utility tax outside of the model ▶ Shifts the installation of window coverings by the vendor from the retail to the construction contracting classification
Yuma	▶ Exempts rental property tax for properties occupied for 90 days or longer

All of these variations appear on the green pages of the master version of the model city tax code.
Prepared by: League of Arizona Cities and Towns. October 1999.

RESOLUTION #2

Support federal and state efforts to ensure a level playing field for businesses and citizens in the new electronic marketplace and ensure that cities and towns can receive transaction privilege (sales) taxes on out-of-state or remote electronic and mail order transactions.

Submitted by: Cities of Scottsdale, Avondale, Mesa, Phoenix and Tucson

♦ ♦ ♦ ♦ ♦ ♦ ♦ ♦ ♦ ♦

A. Purpose of the Resolution

The purpose of this resolution is to make state and federal legislators aware that the Internet's tax-free status has a strong negative impact on the local community. The Arizona Legislature has formed an Internet sales tax study committee to look at the impact of Internet transactions on state and local revenue. The Internet enjoys an unfair advantage over local retail stores. Local retail stores pay property taxes that support local government and schools. Local stores hire workers who may face unemployment. Local stores collect transaction privilege (sales) taxes, which represent significant sources of income for local government.

A tax-free Internet will contribute to an increase in the failure rate of local businesses, an increase in the unemployment rate and a reduction in the capacity of state and local governments to deal with these problems. It will also weaken the local property tax base which supports schools and government services.

B. Effect of the Resolution

While only Congress has the authority to change federal laws which will allow states and local governments to tax Internet sales as well as mail order sales, it is important that the State Legislature and cities and towns in Arizona develop a united front to protect local businesses and jobs as well as the property and transaction privilege (sales) tax base. This resolution seeks to protect the revenue base for the state, cities and towns, in order to continue their ability to provide public services, such as public safety, public infrastructure, economic development and education.

C. Fiscal Impact

It is difficult to predict the amount of revenue that will be lost to states and local governments if sales taxes on Internet transactions are permanently preempted. However, by using industry estimates and existing tax rates, Scottsdale estimates their potential cumulative loss over the next five years between \$7 and \$10 million.

City/Town Variations from the Model City Tax Code

- | | |
|-----------------|--|
| Avondale | ▶ Uses a different licensing structure |
| Casa Grande | ▶ Exempts from taxation sales of job printing shipped or delivered out-of-state |
| Chandler | ▶ Uses a different licensing structure; chemicals used in manufacturing are taxed |
| Chino Valley | ▶ Imposes an additional tax on pipeline operations |
| Eagar | ▶ Exempts from taxation logging |
| Flagstaff | ▶ Exempts from taxation logging
▶ Exempts from taxation transporting persons or property by railroad |
| Glendale | ▶ Uses a different licensing structure
▶ Exempts from taxation owners of four or less real property rental units
▶ Exempts from taxation dance studios |
| Mesa | ▶ Uses a different licensing structure |
| Nogales | ▶ Exempts from taxation non-retail sales to purchasers from foreign countries |
| Peoria | ▶ Uses a different licensing structure |
| Phoenix | ▶ Uses a different licensing structure
▶ Makes additional requirements on the advertising tax
▶ Imposes an additional tax on nonresidential leases & short-term motor vehicle rentals
▶ Grants a special tax credit offset for cable licenses
▶ Imposes a tax on wastewater removal services |
| Prescott Valley | ▶ Imposes a tax on wastewater collection and treatment |
| Scottsdale | ▶ Uses a different licensing structure
▶ Imposes a tax on wastewater removal services |
| Surprise | ▶ Sets a lower rate on food sales |
| Tempe | ▶ Uses a different licensing structure
▶ Exempts from taxation dance studios |
| Tucson | ▶ Adds a definition of "combined taxes"
▶ Excludes certain activities occurring on Davis Monthan Air Force Base
▶ Phased out special tax on advertising
▶ Imposes a public utility tax outside of the model
▶ Shifts the installation of window coverings by the vendor from the retail to the construction contracting classification |
| Yuma | ▶ Exempts rental property tax for properties occupied for 90 days or longer |

All of these variations appear on the green pages of the master version of the model city tax code.
Prepared by: League of Arizona Cities and Towns. October 1999.

Appendix F:
Letter submitted by DOR
on the Uniform Audit Committee

ARIZONA DEPARTMENT OF REVENUE

1600 WEST MONROE - PHOENIX, ARIZONA 85007-2650

JANE DEE HULL
GOVERNOR



MARK W. KILLIAN
DIRECTOR

October 06, 1999

The Honorable Lori Daniels
Majority Leader
AZ House of Representatives
1700 W. Washington
Phoenix, AZ 85007

The Honorable Scott Bundgaard
Chairman, Finance Committee
AZ State Senate
1700 W. Washington
Phoenix, AZ 85007

Dear Representative Daniels and Senator Bundgaard:

This letter is in response to a request made by Melodie Jones, House Research Analyst, regarding the unified audit program and DOR's role in the program.

ARS § 42-6001(A) and (B) (established by initiative measure in 1972) allow DOR to collect and administer any transaction privilege license tax or use tax imposed by any city or town and to enter into intergovernmental contracts or agreements with cities and towns of this state to provide a uniform method of administration, collection, audit and licensing of transaction privilege license taxes and use tax imposed by the state or cities or towns pursuant to title 11, chapter 7, article 3.

Pursuant to statute DOR entered into agreements with the various cities and towns to establish a Unified Audit Committee (UAC). The UAC consists of any city or town in this state with a transaction privilege or use tax that wishes to participate. The UAC meets every two months to discuss issues of importance to the cities, including possible changes to the Model City Tax Code. The Cities Program Manager, of the DOR, acts as liaison between the DOR and the cities on the UAC. The Cities Program Manager also represents the cities in the DOR collection program.

Although DOR represents those cities and towns that have contracted with us to administer their tax that does not prevent them from becoming a member of the UAC in

OTHER LOCATIONS: Tucson Government Mall – 400 W. CONGRESS - TUCSON
East Valley – 3191 N. WASHINGTON STREET - CHANDLER
North Valley – 2902 W. AGUA FRIA FREEWAY - PHOENIX

their own right. Currently, several program cities actively participate in the UAC, such as Lake Havasu City, Gilbert, Goodyear and Cottonwood. Independent auditors hired by Gilbert and Cottonwood act as their representatives to the UAC; however, they do not attend all meetings. The City of Lake Havasu is a permanent member of the UAC and sends their Tax and License Supervisor to all meetings. Of the non-program cities, Nogales has never been a member of the UAC; however, their independent auditor attends on behalf of Gilbert and is aware of the issues and the consensus of opinion by the member cities. In recent years, the City of Peoria has not been sending a representative to the meeting but they do remain as a member.

The UAC discusses complex audit issues that arise in the various cities and comes to a consensus on how to handle these issues. The DOR representative provides information on how the Department's audit area is handling the issue. Where the language in title 42 and the Model City Tax Code are similar, the committee follows the Departments' policy.

The Cities and the DOR exchange information on the various court cases that have been recently settled and the impact on audit procedures and Statute/Code interpretation so that during an audit, the issues will be handled according to the appropriate interpretation of the Statute/Code.

The UAC also provides a forum for industry to petition for a change to the Model City Tax Code. The specific industry representative arranges to present their case for a change to the UAC at one of their meetings. The UAC takes the information under advisement and makes a decision whether to include the industry proposal in their changes to go before the Municipal Tax Code Commission. A sub-committee may be formed to research the proposal and meet with the industry representatives to come to an agreement to be presented back to the full committee for approval.

After the State Legislature meets each year, the UAC reviews the changes to the Statutes (Title 42) on Transaction Privilege Tax and works with industry representatives (Arizona Tax Research Association) to determine which of the state changes will be incorporated into the Model City Tax Code to conform it to state statute. Once these changes are agreed upon, they are presented by the League of Arizona Cities and Towns and the UAC to the Municipal Tax Code Commission for a public hearing and approval to submit the changes to the various City and Town Councils for adoption to the Model City Tax Code and each towns adopted version.

The DOR City Program Manager acts as staff to the Municipal Tax Code Commission. All program cities and towns provide DOR with a copy of any ordinance that changes the city tax code or tax rate and DOR sends out notification of those changes to the taxpayers. The non-program cities notify their taxpayers of any changes to their code or tax rates.

Once a year, DOR and the non-program cities that participate meet to determine who will be doing multijurisdictional audits. The planned large audits for the fiscal year are matched and the State does audits for those non-program cities who plan to audit the same taxpayer, or one of the Cities will do an audit for all the other cities and/or the State.

This is to relieve the burden from the taxpayers of having several jurisdictions in their establishment at various times to audit them. Currently this is done only for large taxpayers.

If during the course of making an audit appointment a city finds that the State is already at the taxpayer's business conducting an audit, the city may make the request that the State conduct the audit for that city as well. This is also to reduce the burden on the taxpayer.

Lastly, DOR and member non-program cities exchange audit information.

Please call me at 542-3970 if you have any additional questions.

Sincerely,



Vince Perez

Director's Executive Officer

Cc; Melodie Jones, House Research Analyst
Jeff Kros, Senate Research Analyst

Appendix G:
Audit Survey Responses
Major State Revenues Shared with Cities

Responses to TPT Administration & Audit Questions

Cities not in the State Collection System

FY 1999 (or four year average) - REVISED

	Avondale	Chandler	Flagstaff	Glendale	Mesa	Peoria	Phoenix	Prescott	Scottsdale	Tempe	Tucson
How many audits does the city perform each year & what are the number of appeals?	60 audits/yr & 2 appeals in 5 yrs	150 audits/yr & 3 or < appeals	62 audits/yr & 2 appeals/yr	128 audits/yr & 11 appeals	165 audits & 3 appeals in previous 2 fiscal years	162 audits/yr & 4.5 appeals	522 audits & 27 appeals	112 audits/yr & 0 appeals in last 4 yrs	328 audits/yr & 6 appeals	140 to 200 audits/yr with 2 to 5 appeals/yr	450 to 530 audits/yr with 14 to 26 appeals/yr
How many auditors on staff & what is the cities audit budget?	0.5 FTE	3.0 FTE	2.0 FTE	3.0 FTE	6.0 FTE	2.0 FTE	27.0 FTE	1.5 FTE	5.0 FTE	6.0 FTE	14.0 FTE
What is the average time spent on a city tax audit?	17 hours	12 hours	20 hours	23 hours	40-50 hours	37.5 hours	28 hours	11 hours	8 hours	34 hours	28 hours
How much money was collected from local sales tax audits?	\$133,141	\$385,808	\$284,858	\$302,021	\$930,000	\$580,000	\$3,413,898	\$98,500	\$1,727,036	\$2,186,560	\$866,373

Source: Responses received from the cities from a survey sent by Representative Daniels on 9/29/99.

Responses to a similar survey sent in 1993

	Avondale	Chandler	Flagstaff	Glendale	Mesa	Peoria	Phoenix	Prescott	Scottsdale	Tempe	Tucson
How much is your annual budget for sales tax audits	\$31,640	\$75,000	\$43,700	\$189,175	\$326,520	N/A	\$2,260,000	\$45,000	\$483,934	\$201,600	\$800,580
How many appeals did your city receive from sales tax audits?	0	5	8	10	15	N/A	37	1	10	11	45
What is the average time spent on a city tax audit?	N/A	Depends on type of business	Depends on type of business	18 hours	25.6 hours	N/A	63.5 hours	Depends on type of business	21 hours	31 hours	50 hours
How much money was collected from local sales tax audits?	N/A	\$185,000	\$41,132	\$312,766	\$999,615	N/A	\$5,250,000	\$68,000	\$891,535	\$706,597	\$1,870,000

NOTES:

1. Avondale numbers are for FY 1994.

source: League of City & Towns Survey conducted 9/93

Major State Revenues Shared with Cities & Towns

Model City Tax Code -- Uniformity Study Committee

November 8, 1999

County	City/Town	Population	% of Total	Revenue Sharing	1999 Urban TPT Distribution	1999 Urban VLT Distribution	1999 Urban HURF Dist.	1999 Urban TOTAL
Apache	Eagar	4,515	0.1326%	\$451,257	\$361,210	\$184,007	\$1,172,794	\$2,169,268
Apache	Springerville	1,920	0.0564%	\$191,897	\$153,604	\$78,249	\$502,730	\$926,480
Apache	St. Johns	3,360	0.0987%	\$335,819	\$268,807	\$136,935	\$885,175	\$1,626,737
Cochise	Benson	4,115	0.1209%	\$411,279	\$329,209	\$120,865	\$406,345	\$1,267,698
Cochise	Bisbee	6,500	0.1909%	\$649,651	\$520,014	\$190,917	\$645,000	\$2,005,582
Cochise	Douglas	14,780	0.4341%	\$1,477,206	\$1,182,432	\$434,116	\$1,455,527	\$4,549,281
Cochise	Huachuca City	1,940	0.0570%	\$193,896	\$155,204	\$56,981	\$190,861	\$596,943
Cochise	Sierra Vista	37,815	1.1106%	\$3,779,468	\$3,025,282	\$1,110,696	\$3,719,487	\$11,634,933
Cochise	Tombstone	1,405	0.0413%	\$140,425	\$112,403	\$41,267	\$138,314	\$432,409
Cochise	Willcox	3,533	0.1038%	\$353,110	\$282,648	\$103,771	\$347,025	\$1,086,554
Coconino	Flagstaff	54,480	1.6000%	\$5,445,073	\$4,358,518	\$1,945,163	\$7,207,158	\$18,955,912
Coconino	Fredonia	1,250	0.0367%	\$124,933	\$100,003	\$44,630	\$167,883	\$437,449
Coconino	Page	7,950	0.2335%	\$794,573	\$636,017	\$283,848	\$1,057,142	\$2,771,580
Coconino	Williams	2,690	0.0790%	\$268,855	\$215,206	\$96,044	\$361,212	\$941,318
Gila	Globe	7,058	0.2073%	\$705,421	\$564,655	\$407,853	\$810,735	\$2,488,664
Gila	Hayden	910	0.0267%	\$90,951	\$72,802	\$52,585	\$104,904	\$321,242
Gila	Miami	2,040	0.0599%	\$203,890	\$163,204	\$117,883	\$234,462	\$719,440
Gila	Payson	11,004	0.3232%	\$1,099,809	\$880,344	\$635,876	\$1,252,394	\$3,868,422
Gila	Winkelman	676	0.0199%	\$67,564	\$54,081	\$39,063	\$77,852	\$238,560
Graham	Pima	1,850	0.0543%	\$184,901	\$148,004	\$62,755	\$165,387	\$561,047
Graham	Safford	8,773	0.2577%	\$876,829	\$701,859	\$297,594	\$773,653	\$2,649,935
Graham	Thatcher	3,957	0.1162%	\$395,487	\$316,569	\$134,228	\$355,203	\$1,201,487
Greenlee	Clifton	2,995	0.0880%	\$299,339	\$239,606	\$163,093	\$316,396	\$1,018,435
Greenlee	Duncan	735	0.0216%	\$73,461	\$58,802	\$40,025	\$77,676	\$249,963
La Paz	Parker	2,950	0.0866%	\$294,841	\$236,006	\$203,986	\$943,548	\$1,678,382
La Paz	Quartzsite	2,005	0.0589%	\$200,392	\$160,404	\$138,641	\$640,810	\$1,140,248
Maricopa	Avondale	22,771	0.6688%	\$2,275,877	\$1,821,729	\$768,307	\$1,573,341	\$6,439,253
Maricopa	Buckeye	4,857	0.1426%	\$485,439	\$388,571	\$163,878	\$340,594	\$1,378,482
Maricopa	Carefree	2,286	0.0671%	\$228,477	\$182,885	\$77,131	\$157,245	\$645,738
Maricopa	Cave Creek	3,076	0.0903%	\$307,435	\$246,087	\$103,786	\$215,081	\$872,388
Maricopa	Chandler	132,360	3.8873%	\$13,228,888	\$10,589,086	\$4,465,903	\$9,035,776	\$37,319,654
Maricopa	El Mirage	5,741	0.1686%	\$573,792	\$459,292	\$193,705	\$402,206	\$1,628,995

Prepared by: House staff/mj

11/8/99

model city tax

Major State Revenues Shared with Cities & Towns

Model City Tax Code -- Uniformity Study Committee

November 8, 1999

County	City/Town	Population	% of Total	1999 Urban Revenue Sharing	1999 Urban TPT Distribution	1999 Urban VLT Distribution	1999 Urban HURF Dist	TOTAL
Maricopa	Fountain Hills	14,146	0.4155%	\$1,413,840	\$1,131,711	\$477,294	\$969,293	\$3,992,138
Maricopa	Gila Bend	1,747	0.0513%	\$174,606	\$139,764	\$58,945	\$122,125	\$495,440
Maricopa	Gilbert	59,338	1.7427%	\$5,930,612	\$4,747,168	\$2,002,098	\$3,951,255	\$16,631,134
Maricopa	Glendale	182,615	5.3632%	\$18,251,688	\$14,609,595	\$6,161,536	\$12,682,235	\$51,705,054
Maricopa	Goodyear	9,250	0.2717%	\$924,503	\$740,020	\$312,100	\$631,614	\$2,608,237
Maricopa	Guadalupe	5,458	0.1603%	\$545,507	\$436,652	\$184,156	\$381,546	\$1,547,861
Maricopa	Litchfield Park	3,739	0.1098%	\$373,699	\$299,128	\$126,156	\$262,386	\$1,061,369
Maricopa	Mesa	338,117	9.9302%	\$33,793,533	\$27,050,091	\$11,408,263	\$29,189,770	\$101,441,658
Maricopa	Paradise Valley	12,448	0.3656%	\$1,244,131	\$995,867	\$420,003	\$870,633	\$3,530,634
Maricopa	Peoria	74,565	2.1899%	\$7,452,494	\$5,965,361	\$2,515,866	\$5,091,160	\$21,024,881
Maricopa	Phoenix	1,149,417	33.7574%	\$114,879,943	\$91,955,847	\$38,781,993	\$97,729,446	\$343,347,229
Maricopa	Queen Creek	3,072	0.0902%	\$307,035	\$245,767	\$103,651	\$214,976	\$871,429
Maricopa	Scottsdale	168,176	4.9392%	\$16,808,564	\$13,454,444	\$5,674,355	\$11,624,642	\$47,562,005
Maricopa	Surprise	10,737	0.3153%	\$1,073,123	\$858,983	\$362,273	\$731,151	\$3,025,530
Maricopa	Tempe	153,821	4.5176%	\$15,373,835	\$12,306,013	\$5,190,009	\$10,767,285	\$43,637,142
Maricopa	Tolleson	4,436	0.1303%	\$443,362	\$354,890	\$149,673	\$310,098	\$1,258,022
Maricopa	Wickenburg	4,765	0.1399%	\$476,244	\$381,210	\$160,774	\$333,699	\$1,351,927
Maricopa	Youngtown	2,694	0.0791%	\$269,255	\$215,526	\$90,897	\$188,712	\$764,390
Mohave	Bullhead City	26,940	0.7912%	\$2,692,553	\$2,155,258	\$1,138,451	\$2,765,189	\$8,751,451
Mohave	Colorado City	3,190	0.0937%	\$318,829	\$255,207	\$134,805	\$325,703	\$1,034,544
Mohave	Kingman	16,769	0.4925%	\$1,675,999	\$1,341,556	\$708,637	\$1,717,371	\$5,443,564
Mohave	Lake Havasu	36,285	1.0657%	\$3,626,550	\$2,902,878	\$1,533,359	\$3,648,763	\$11,711,551
Navajo	Holbrook	5,070	0.1489%	\$506,728	\$405,611	\$210,208	\$674,741	\$1,797,288
Navajo	Pinetop-Lakeside	3,301	0.0969%	\$329,923	\$264,087	\$136,863	\$435,380	\$1,166,253
Navajo	Show Low	6,988	0.2052%	\$698,425	\$559,055	\$289,731	\$919,216	\$2,466,426
Navajo	Snowflake	4,120	0.1210%	\$411,779	\$329,609	\$170,820	\$548,442	\$1,460,650
Navajo	Taylor	2,655	0.0780%	\$265,357	\$212,406	\$110,079	\$353,761	\$941,604
Navajo	Winslow	10,780	0.3166%	\$1,077,421	\$862,423	\$446,951	\$1,434,806	\$3,821,602
Pima	Marana	5,309	0.1559%	\$530,615	\$424,731	\$186,530	\$409,559	\$1,551,435
Pima	Oro Valley	19,657	0.5773%	\$1,964,644	\$1,572,603	\$690,641	\$1,521,025	\$5,748,912
Pima	Sahuarita	2,311	0.0679%	\$230,976	\$184,885	\$81,196	\$175,798	\$672,855
Pima	South Tucson	5,452	0.1601%	\$544,907	\$436,172	\$191,554	\$462,881	\$1,635,514

Prepared by: House staff/mj

11/8/99

model city tax

Major State Revenues Shared with Cities & Towns

Model City Tax Code -- Uniformity Study Committee

November 8, 1999

County	City/Town	Population	% of Total	1999 Urban Revenue Sharing	1999 Urban TPT Distribution	1999 Urban VLT Distribution	1999 Urban HURF Dist.	TOTAL
Pima	Tucson	443,225	13.0171%	\$44,298,686	\$35,458,959	\$15,572,532	\$43,310,832	\$138,641,009
Pinal	Apache Junction	19,525	0.5734%	\$1,951,451	\$1,562,042	\$710,251	\$1,759,940	\$5,983,684
Pinal	Casa Grande	20,880	0.6132%	\$2,086,878	\$1,670,445	\$759,541	\$1,885,870	\$6,402,735
Pinal	Coolidge	7,055	0.2072%	\$705,121	\$564,415	\$256,636	\$637,075	\$2,163,247
Pinal	Eloy	8,915	0.2618%	\$891,021	\$713,219	\$324,297	\$797,974	\$2,726,511
Pinal	Florence	11,390	0.3345%	\$1,138,388	\$911,225	\$414,328	\$999,012	\$3,462,953
Pinal	Kearny	2,455	0.0721%	\$245,368	\$196,405	\$89,304	\$221,640	\$752,718
Pinal	Mammoth	1,960	0.0576%	\$195,895	\$156,804	\$71,298	\$177,657	\$601,654
Pinal	Superior	3,485	0.1024%	\$348,313	\$278,808	\$126,772	\$314,355	\$1,068,247
Santa Cruz	Nogales	20,655	0.6066%	\$2,064,390	\$1,652,445	\$823,435	\$2,049,914	\$6,590,183
Santa Cruz	Patagonia	945	0.0278%	\$94,449	\$75,602	\$37,673	\$94,151	\$301,876
Yavapai	Camp Verde	7,465	0.2192%	\$746,099	\$597,216	\$377,570	\$709,876	\$2,430,761
Yavapai	Chino Valley	6,255	0.1837%	\$625,164	\$500,414	\$316,370	\$591,776	\$2,033,723
Yavapai	Clarkdale	2,600	0.0764%	\$259,860	\$208,006	\$131,505	\$246,716	\$846,087
Yavapai	Cottonwood	6,545	0.1922%	\$654,148	\$523,614	\$331,038	\$621,719	\$2,130,519
Yavapai	Jerome	460	0.0135%	\$45,975	\$36,801	\$23,266	\$44,385	\$150,428
Yavapai	Prescott	31,086	0.9130%	\$3,106,930	\$2,486,947	\$1,572,291	\$2,908,625	\$10,074,793
Yavapai	Prescott Valley	16,043	0.4712%	\$1,603,438	\$1,283,475	\$811,435	\$1,420,453	\$5,118,800
Yavapai	Sedona	8,894	0.2612%	\$888,922	\$711,539	\$449,847	\$948,331	\$2,998,640
Yuma	San Luis	8,026	0.2357%	\$802,169	\$642,097	\$272,426	\$763,164	\$2,479,857
Yuma	Somerton	5,824	0.1710%	\$582,087	\$465,933	\$197,684	\$579,933	\$1,825,637
Yuma	Wellton	1,126	0.0331%	\$112,540	\$90,082	\$38,220	\$112,415	\$353,257
Yuma	Yuma	60,457	1.7756%	\$6,042,452	\$4,836,691	\$2,052,092	\$6,038,703	\$18,969,937
Total		3,404,936	100.00%	340,310,656	272,402,246	118,863,462	294,410,066	1,025,986,430